ANNUAL REPORT
AND ACCOUNTS

2021







Building your future

Principality
Building Society
Cymdeithas Adeiladu

Where home matters
principality.co.uk

2021 Highlights

Great Place To Work. Certified OCT 2021-OCT 2022 UK

87%
engagement score
2020: 86%

Common Equity Tier 1 ratio
33.99%
2020: 27.10%

Charity fundraising for our partners
£58k
2020: £152k

3,900
children supported via financial education initiatives

First Time Buyers helped
2,954

£64.0 million
Statutory profit before tax
2020: £19.9million

Net Promoter Score
2020: 79.8
80.5

Mortgages funded by savers
89.4%
2020: 88.9%

Launch of Green Commercial Fund
£20m

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

07

Chief Executive's Review of the Year

47

Meet the Board of Directors

91

Financial Statements

Strategic Report

Chair's Review of the Year

for the year ended 31st December 2021

In presenting this Annual Report to you, our Members, I feel very proud to be the Chair of this Society with 160 plus years of great heritage. I strongly support our Board's consistent focus on putting Members' interests first, on supporting our award-winning colleagues to make the Principality a great place for Members' savings and mortgages, and on ensuring we make a positive impact in our communities. Notwithstanding the ongoing challenges of the global pandemic, 2021 was a busy, productive and successful year for the Society, and you will read more about that in the Report.

This year we said goodbye to our former Chair, Laurie Adams, and thanked him for his immense service to Members, and welcomed Jonathan Baum to our Board. Jonathan's credit risk expertise and wider experience of financial services and data analytics will be a real asset as we continue to keep the Society safe and secure, whilst refreshing our strategy to face the challenges ahead.

Pictured: *Sally Jones-Evans, Chair*

I have focused a lot of my time in 2021 on meeting customers, colleagues, brokers, business partners, our regulators and sector leaders – and to bringing those external stakeholder voices into the Board discussions. As we look to the future I'm delighted to be shaping Principality's plans for the next decade to ensure it delivers the same qualities of value and outstanding customer service in a rapidly evolving financial services market.

As a Board we have been working hard helping to reframe the future of the Society, and our exciting strategic ambitions to have impact beyond our scale will become apparent in 2022. Society as a whole has different expectations of what it wants from businesses today, and although we have had a clear and responsible social purpose from our inception, we are rising to the challenge to refresh this and make it even more prominent and central to all our decision making.

Already we have communicated plans to be carbon net zero in our operations by 2030, and have begun training our colleagues on carbon literacy so they can be the driving force behind making your building society one that is more environmentally friendly and efficient. We are developing some exciting ways in which we can have a deep and sustained social impact in our communities, whilst remaining committed to delivering and even extending our existing programmes to provide financial education to thousands of children in Wales. And we are refreshing the way in which Members can participate in shaping the Society through our Member Forum which already has 1,740 active participants.

It's been such a pleasure to see Principality named as one of the best places to work in the UK again, as our people really are at the heart of our very special culture. I want to thank our amazing colleagues on behalf of you all for their incredible commitment, enthusiasm, and determination to provide exceptional service despite another very tough year for us all.

And of course I want to thank you, our loyal Members, for the fantastic support you have shown us 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.

Sally Jones-Evans
Chair
21st February 2022

Pictured:
Principality colleagues helped raise money for charity partners and community projects in 2021

Pictured:
Fiver Challenge 2021 competition winners

Chief Executive's Review of the Year

for the year ended 31st December 2021

2021 has been another challenging year for our colleagues, our leaders, our customers and our communities. Starting the year in national lockdown, I have been struck by how our colleagues have maintained their focus and commitment to make Principality an attractive, welcoming Society. A Society that looks after our Members' savings and mortgage needs, and I am proud of the progress we have made in 2021.

A trusted business

Our colleagues are passionate about doing the right thing for our Members and supporting our local communities. This is reflected in our Net Promoter Score of more than 80, with 8 out of 10 Members saying they would recommend us to family or friends based on their level of satisfaction with Principality (2020: 79.8). These high satisfaction and service levels were recognised by the What Mortgage award for Best Building Society Customer Service.

We want to ensure we continue to be a responsible, sustainable and future focused business. That means although we will continue to invest in technology to benefit how your Society is run, we will also be investing more so we can help more first time buyers to get a home, help more people to live in carbon neutral homes, ensure our Members have a choice in how we run their building society, and create a much fairer society to live in for customers, colleagues and communities.

Thriving Communities

It has been a very difficult period for the High Street, but as competitors continue to close their branches, I am proud that we have the largest high street brand presence of any financial services company (excluding the Post Office) in Wales and the borders.

Pictured: Julie-Ann Haines, Chief Executive Officer

Your Board and I remain committed to maintaining our 70 branches and agencies until at least 2025 and are delighted that our colleagues can support communities which have faced high street bank closures with friendly helpful access to cash, transactions and our services. We've invested £2.65m in our branches over the last four years, and are set to increase that investment in 2022.

As a major business in Wales, we want our towns to thrive, and financial service organisations have a role to play in ensuring towns and communities prosper. We remain committed to having a Head Office in Cardiff but recognise that the needs of colleagues have changed significantly.

Pictured: Staff at our Albany Road branch celebrating the branch's 50th birthday.

During 2021, our 800 Head Office colleagues have continued to work from home as per the Welsh Government guidance. It has allowed us to start work on creating a much more flexible and adaptable place to work. In the meantime, we are making a significant investment in our Head Office in Cardiff, which will be fully refurbished by the time we welcome back colleagues who wish to return to the office in 2022.

This commitment to our High Street and a Head Office does not deflect us from our focus on developing technology to respond to the demand from Members and customers to interact over the phone, video, and digitally, to enable them to manage their financial affairs.

... at the heart of a diverse and inclusive society

One of our greatest strengths is our people and we strive to create a friendly, open and inclusive culture. It was wonderful to be acknowledged as the 8th best place to work in the UK by Great Place to Work®. Since the beginning of the pandemic, it has been a key focus for us to ensure colleagues feel supported as they adapt to new ways of working. This includes placing a real emphasis on promoting health and wellbeing in what has been a difficult period, and increasing flexible working arrangements to help colleagues achieve a good work-life balance. The Board have agreed to a five year strategy to improve the diversity of our Society and ensure that we continue to build a more inclusive culture.

Better Homes

Our efforts to help first time buyers with attractive propositions saw the number of applications rise with 2,954 people able to get on to the property ladder despite a much more challenging housing market caused by increased demand. This included First Home Steps Online, which will support first time buyers in their savings journey, as well as offering a range of mortgages aimed at newly qualified professionals.

Mortgage customers were given continued support with payment holidays, and we made sure the needs of our Members were met during uncertain times for everyone.

Secure Futures

In 2020, we increased our provisions for potential future loan losses because of the economic uncertainty caused by the pandemic. Over the last year the economic outlook has gradually improved and is more optimistic for 2022. The housing market exceeded expectations during 2021 and employment is more stable than expected after furlough ended, which has resulted in a reduction in our overall level of provisioning. We have achieved an underlying profit before tax of £54.4m (2020: £24.1m) and statutory profit before tax of £64.0m (2020: £19.9m).

At the same time we have maintained our focus on an investment programme which will enable us to offer current and future Members increased flexibility in managing their savings and mortgage needs. This year we have been busy implementing a new mortgage system that will benefit brokers and customers alike by improving the speed of our application process and meet more of our customer needs through offering a wider range of products. It was a combination of bedding in our new system and market conditions which resulted in a small reduction in our mortgage book of £142.4m (2020: growth of £182.2m). Our capital and liquidity levels remain strong, well in excess of regulatory requirements, and well able to withstand any challenging economic and market conditions.

For mutual benefit, helping to build a fairer society

As a mutual organisation, 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.

As a purpose led business, we will continue to work hard to help our communities deal with the many challenges they face. In spring this year we were delighted to announce that our colleagues and the business have helped to raise £1 million for the various charities that we have supported during the past seven years. Our partnership with Teenage Cancer Trust Cymru and Alzheimer's Society came to an end in December, but we were delighted to help raise over £367,000 for them during our three year partnership. The funds we raised for Teenage Cancer Trust Cymru helped them to employ a specialist regional nurse for the first time ever.

We are so proud to have continued supporting a number of incredible financial education charities in 2021, all of which we have worked with for a number of years. With the London Institute of Banking & Finance (LIBF) a £35,000 financial education fund (enabling over 25 secondary schools to access GCSE equivalent qualifications) was set up and this has helped more than 500 schoolchildren. Since 2020, we have supported 2,000 young people in Wales with financial education qualifications from the LIBF and announced we will invest £100,000 to continue this support.

With Young Enterprise we proudly sponsored the Fiver Challenge across Wales for the second consecutive year and it was great to see over 3,000 primary school pupils set up their own businesses with a £5 investment. This featured lots of learning, a big environmental focus and some great profits too.

In North Wales, we have continued to work with the Xplore (STEM) charity in Wrexham, donating £15,000 towards numeracy based workshops for kids.

We also launched Dylan's Saving Squad financial education resource hub for teachers online to help children learn about the importance of saving with interactive games they can do with their families and at school.

Our path to becoming a more sustainable organisation

We have spent time focusing on how we make sure we build on our mutual ethos in a way that has more relevance with the needs of our current and future Members. For example, we are focusing on our sustainability as an organisation, and have set an ambitious target to be carbon net zero by 2030. As well as off-setting our carbon footprint over the past few years by planting trees with the Woodland Trust, our award-winning Commercial team introduced a green loan fund to support developers who are building carbon neutral homes across Wales. We're also partnering with Sero, a Welsh based FinTech, to identify how we can support our Members who want to improve the sustainability of their homes.

Outlook

The economic environment looks to be more optimistic next year and beyond, although the impact of the coronavirus pandemic will shape both the wider environment and our Society for years to come. Our focus remains on helping Members to get a home and stay in a home for longer, to become a much more purpose-led and sustainable business, and to honour our commitment to developing and growing our business in a safe and secure way. Our Members' expectations of us are changing. So we will continue to adapt, invest and improve so that we remain relevant for the long term and ready to face future challenges.

Julie-Ann Haines
Chief Executive Officer (CEO)
21st February 2022

Business Model and Strategy

for the year ended 31st December 2021

Our purpose and vision

Principality Building Society was founded 161 years ago in Church Street, Cardiff. Then known as Principality Permanent Investment Building Society, its aim was to encourage people to save in order to achieve the safety and security of owning their own home. That guiding principle is as relevant today as it was then.

Our enduring purpose is to help our Members prosper in their homes. They tell us that home is the heart of life, where their plans, decisions and memories are made and it is where we can help change our Members lives for the better. Our purpose underpins everything that we do but it is not just about the products and services we offer – it is about the value we add to people's lives at every stage.

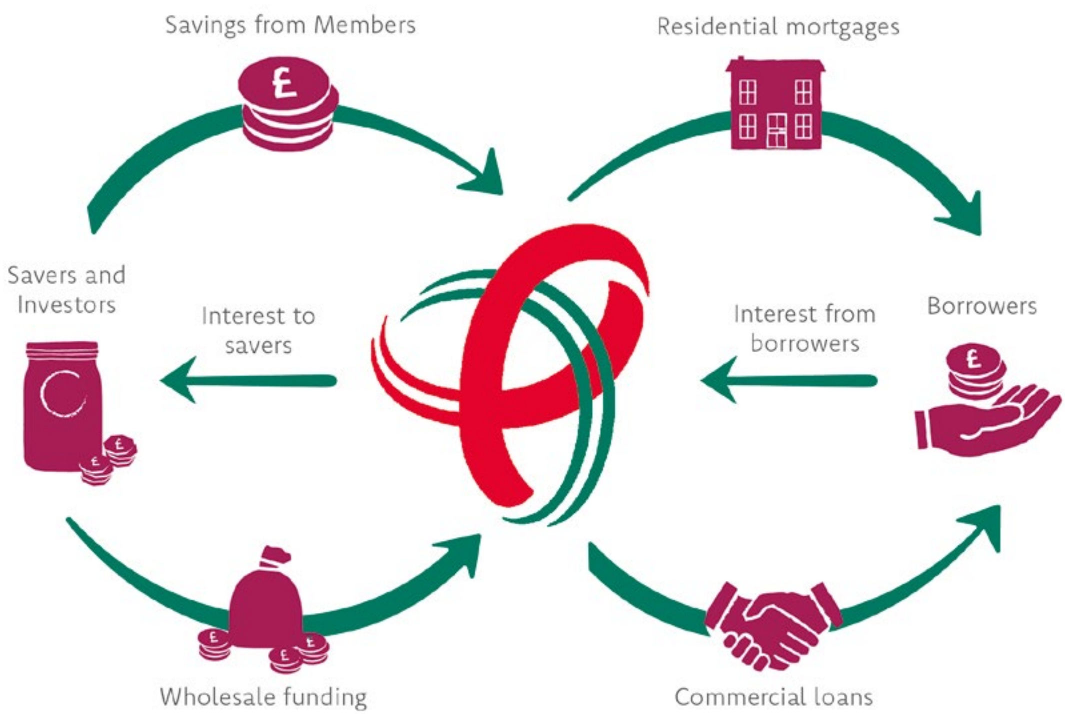
Our purpose and commitment to our Members also informs our strategic thinking and has helped us to develop our vision to deliver products and solutions that meet their current and future needs, by allowing them to do business with us through any channel that they want to – seamlessly. Achieving our vision will ensure we remain relevant, providing financial solutions that Members need and improving access to our range of products and services.

Pictured: Principality Commercial received three awards at the Cardiff Property Awards 2021

Our business model

Our business model operates across two primary lines of business: retail financial services and commercial lending, whilst our distribution channels allow us to reach customers through branches, our broker network, over the phone and digitally. Our secured personal lending business, Nemo, stopped offering new customer loans in 2016 but continues to focus on delivering excellent customer service and delivering a positive contribution to the group results. Additional income contribution also comes from our range of complementary products including life insurance, home insurance and funeral plans, all helping with the goal of protecting Members to be financially resilient throughout their lives.

As a mutual building Society, we are owned by and run for the benefit of our 500,000 plus Members – our savers and borrowers. Our business model raises over 80% of our funds from Members savings and deposit accounts, enabling us to provide loans secured against residential and commercial properties. The difference between the income earned on these loans and the interest paid to savers and wholesale funding providers generates net interest income for the Society. This is used for a number of purposes including enhancing our offering to ensure we are helping Members to prosper in their homes, covering operational expenses, reinvesting in our business, colleagues and technology to future proof our position. We do this whilst continuing to support community and charity projects through our branch and agency network. We do this to ensure we deliver on our purpose, all whilst remaining financially secure and holding capital to safeguard the Society for future generations.



Our strategy

Our strategy helps us to deliver on our purpose. It clearly sets out our focus around our core mortgage and savings business, driving sustainable growth through customer focused propositions tailored to Members' needs, and commitment to delivering excellent customer experience. We delivered this through continuously improving processes and developing expertise in capable, empowered colleagues. 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 pillars.

Strategic Pillars	Key Activity	Performance Indicators
PURPOSE LED ORGANISATION "We'll be a **Purpose Led Organisation** helping customers prosper in their homes at every stage in life"	We'll transform our Savings and Mortgage products to help people to prosper in their homes. We'll be famous in Wales and beyond so we can become a Challenger Building Society. We'll actively manage our costs to ensure we provide maximum value to our Members and create a robust, scalable Society. We'll work within our communities to provide support and create opportunities for them to prosper.	Net Savings Growth Net Mortgage Growth Brand Consideration Cost Income Ratio Commercial Lending Growth
BRILLIANT PEOPLE "We'll inspire **Brilliant People** across the Society with a customer focussed culture"	We'll be an employer of choice, and regarded as a Great Place to Work continuing to attract and retain talented and passionate people. We'll inspire a strong inclusive customer focussed culture, investing in our colleagues and building their capability as we transform our Society. We'll empower our colleagues to live our values, helping them to prosper at every stage of their working life.	Employee Engagement Score
STAND-OUT EXPERIENCE "We'll provide our Members with a **Stand-Out Experience** focussed on customer service and the safety and security of their Society"	We'll put customer experience at the heart of what we do, using insight to drive the right actions and decisions. We'll invest in providing choice and personal service to our customers, while creating a digital channel that complements our existing channels. We'll do the basics right, providing safety, security and reliability to our Members in a fast changing market.	Net Promoter Score Profit Before Tax Net Interest Margin Common Equity Tier 1 Ratio

Our progress

During the last five years, we have focused on delivering our strategy and are investing in a number of key areas to ensure the organisation continues to be successful in the future. A summary of progress against our strategic aims is below:

Purpose Led Organisation

Investment in technology to support the transformation and growth of our core mortgage and savings products, allowing us to be more agile as an organisation and develop a pipeline of products and services aligned to Member needs.

Commercial lending focus on supporting communities to prosper through funding of projects including residential developments and regeneration commercial development. Commercial lending has a focus on providing loans to both existing and new customers across the sectors of Registered Social Landlords (RSLs), residential investment, commercial investment and residential development.

Continued growth of brand awareness as we leverage the sponsorship of Principality Stadium and the exposure generated by our involvement with the WRU.

Commitment to our charity partnerships despite challenging economic times.

Commercial lending awards include Funder of the year and recipient of a Green initiative award.

Brilliant People

Continued investment in people and talent development, with a clear focus on recruiting colleagues who are a strong cultural fit, are dedicated to delivering a great Member experience and demonstrating values that align to our own.

Enhanced focus on equality, diversity and inclusion.

Investment in the working environment, including redevelopment of Principality House and Friary House and refurbishment of the branch network as part of our branch of the future project.

Awards include Finance team of the year (planning & performance) at the Finance Awards Wales.

Continued recognition as a Great Place to Work™.

Stand-Out Experience

Named Best Building Society Customer Service by the What Mortgage Award for the fourth year running.

Investment in our digital capability, allowing more Members than ever to interact with us online.

Ongoing monitoring of customer feedback using insight to inform decision-making, ensuring we continue to deliver service excellence.

Our strong financial performance has enabled us to invest in activity aligned to our purpose, while ensuring that we maintain the high levels of service our Members expect from us.

Transforming our Society

The COVID-19 pandemic has had a significant impact on Wales, the UK and globally in 2020 and 2021, for both Members and our business. As a result, the world we live in is changing at an increasingly fast pace, with forced technology adoption having a significant impact on the way many people interact with financial services organisations, in turn raising the expectations placed upon us. We remain committed to the High Street but also recognise that we need to adapt to remain relevant and improve accessibility to our business, and for this, investment in technology and our digital platforms is vital to ensure our ongoing success. We have continued our transformation journey through a difficult two year period due to COVID-19, making good progress through the delivery and implementation phase, but as we do Member experience will remain at the heart of our decision-making. As we improve our digital capability, we remain dedicated to maintaining the same stand-out experience that Members currently receive, ensuring a consistent experience as we take steps to improve interactions with us across each of our channels.

Key Performance Indicators

Our performance against our strategy is measured through the Key Performance Indicators that are aligned to our strategic pillars. This alignment provides us with clear sight of the progress we are making toward achieving our vision and ensuring our Members prosper in their homes at every stage of life.

Purpose Led Organisation	2021 £m	2020 £m
Net Retail Mortgage Growth	£(142.4)m	£182.2m
Net Savings Growth	£(238.4)m	£596.1m
Brand Consideration[1]	24.0%	17.6%
Cost Income Ratio	70.5%	71.8%
Brilliant People		
Employee Engagement Score	87.0%	86.0%
Stand-Out Experience		
Net Promoter Score[2]	80.5%	79.8%
Statutory Profit Before Tax	£64.0m	£19.9m
Underlying Profit Before Tax[3]	£54.4m	£24.1m
Net Interest Margin	1.17%	1.00%
Common Equity Tier 1 Ratio[4]	33.99%	27.10%

1. Brand consideration is a measure of how potential customers view Principality when choosing a financial services provider, and has increased year on year.

2. Source: Based on internal survey data for the 12 months ended 31st December 2021.

3. Reconciliation can be found on page 17.

4. The Common Equity Tier 1 (CET1) ratio has been impacted by changes to the capital regulations regarding the treatment of intangible assets for capital purposes. The PRA have announced the reversal of this change in 2022. Without this change, the group's CET1 ratio would have been 33.52% at 31st December 2021 (2020: 26.40%).

The above Key Performance Indicators, apart from 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, or definitions included within the glossary.

Pictured: Staff at Principality's Merthyr branch celebrating 50 years on the high street

Pictured: Our Commercial team at the Bridgend development site

Financial Review

for the year ended 31st December 2021

Income statement overview:

Continuing Operations	2017 £m	2018 £m	2019 £m	2020 £m	2021 £m
Net interest income	125.9	119.6	111.4	108.6	129.1
Other income	7.5	5.6	4.4	2.7	3.0
Fair value gains/(losses)	4.3	(2.4)	(0.2)	(4.1)	9.6
Operating expenses	(89.6)	(81.5)	(80.1)	(79.9)	(93.1)
Impairment provisions release/(charge)	10.0	(0.6)	4.1	(9.1)	15.4
Other provisions	(0.5)	-	-	1.7	-
Statutory profit before tax	**57.6**	**40.7**	**39.6**	**19.9**	**64.0**

Statutory profit before tax for 2021 has increased from the prior year to £64.0m (2020: £19.9m). This year has seen increasing house prices and a gradual improvement in economic outlook with a more optimistic view for 2022, resulting in a £15.4m release of impairment provisions compared with a £9.1m charge in 2020. Net interest income has increased primarily due to reduced funding costs as a result of the low interest environment and fall in retail deposits. Fair value losses incurred in 2020 have reversed and have been replaced by fair value gains as financial markets have responded to lower levels of uncertainty and the increase in the Bank of England's base rate.

Underlying profit before tax, which primarily excludes fair value movements and reflects the true trading performance of the business was £54.4m (2020: £24.1m).

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

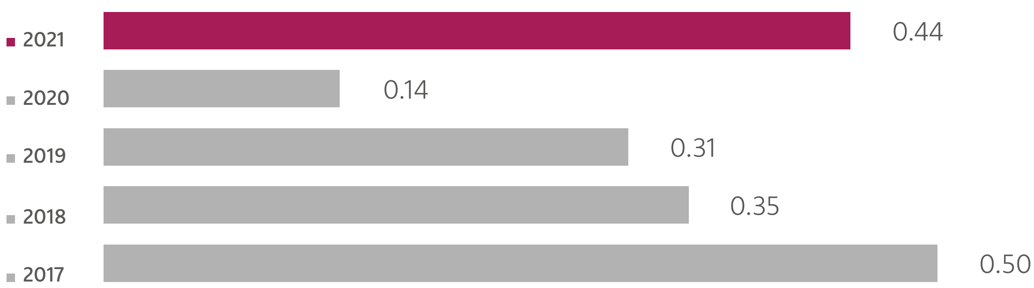
	2021 £m	2020 £m
Statutory profit before tax	64.0	19.9
Adjusted for:		
Fair value (gains)/losses	(9.6)	4.1
Additional pension charge for GMP (Guaranteed Minimum Pension) equalisation	-	0.1
Underlying profit	**54.4**	**24.1**

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 principle difference between statutory and underlying profit before tax is fair value movements, which represent the change in value of certain assets and liabilities to reflect underlying market rates. These movements are primarily timing differences, which in any given year can be an overall loss or a gain; however, this will reverse as the asset or liability approaches maturity and therefore trend to zero over time. In 2021, a fair value gain was experienced as markets recovered from the downturn caused by the COVID-19 pandemic, and reacted to the rise in the Bank of England base rate in December 2021.

Return on assets, calculated as statutory profit after tax divided by average total assets, has increased compared with the prior year. This is driven by the increased profit discussed above.

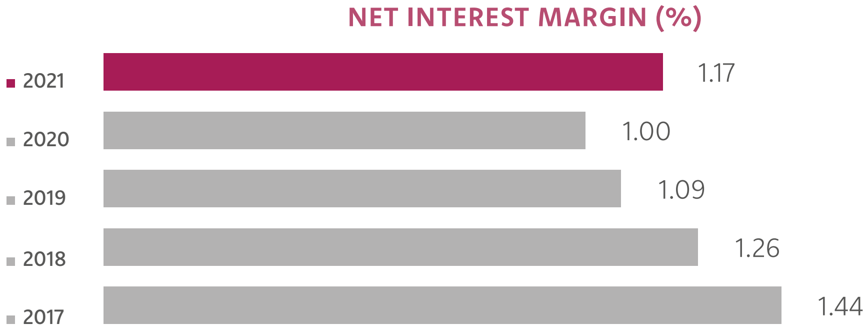
RETURN ON ASSETS (%)



Net Interest Margin

Our net interest margin for the year was 1.17% (2020: 1.00%). This increase is primarily due to a reduction in funding costs, driven by a shift in the retail savings market pricing and the use of the Bank of England's Term Funding Scheme (TFSME) to refinance planned wholesale maturities. Such forms of funding provide us with security over a longer-term and increased stability in uncertain market conditions. In response to lower funding costs, retail mortgage pricing has also fallen over the period, which together with the planned reduction in the loan assets held in the secured personal lending portfolio to £108.4m (2020: £141.2m) has resulted in a £6.9m reduction in interest receivable and a £27.5m reduction in interest payable.

Our lending continues to be primarily funded by Members' retail savings, with 89.4% (2020: 88.9%) 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.



Operating expenses

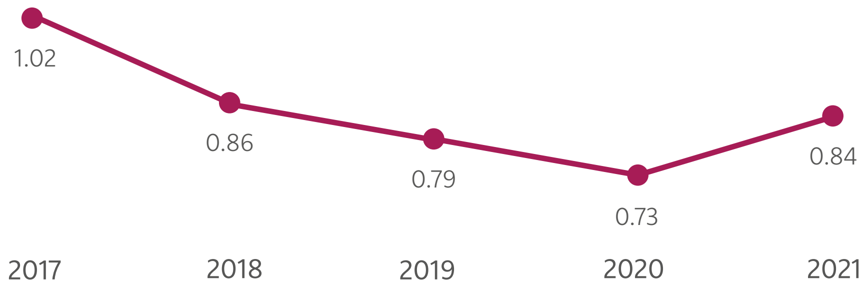
We recognise that operating efficiently is a significant factor in achieving optimal Member value, and as such operating expenses remain a key area of focus. Operating expenses increased in the year to £93.1m (2020: £79.9m); material changes from last year include £1m impairment of intangible assets and £1.5m property impairment, as well as a £5.5m increase in staff costs. Operating expenses were expected to increase following investment in our change delivery model and amortisation from intangible assets generated by the investment in our core mortgages and savings platforms, with management consultancy expenses increasing by £1.1m and amortisation increasing by £2.3m year-on-year as a result. Focus on managing the core cost base of the business as a proportion of assets remains a priority.

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

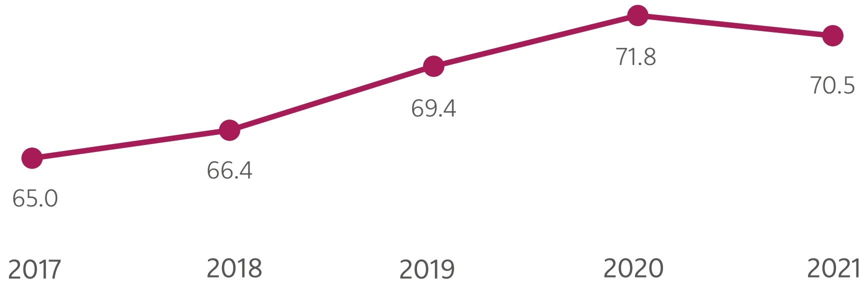
	2021 £m	2020 £m
Retail financial services	89.8	77.1
Commercial lending	2.6	2.5
Secured personal lending	0.7	0.3
Total operating expenses	**93.1**	**79.9**
Management expense ratio	0.84%	0.73%
Cost income ratio	70.5%	71.8%

The management expense ratio, which compares costs as a proportion of the average assets of the business, has increased due to an expected increase in our cost base and a lower level of assets. 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 2022 and beyond.

MANAGEMENT EXPENSE RATIO (%)



COST/INCOME RATIO (%)



STRATEGIC REPORT

Impairment provisions for losses on loans and advances

	2021 £m	2020 £m
Retail mortgage lending	(3.9)	1.7
Commercial lending	(9.2)	7.7
Secured personal lending	(2.4)	(0.6)
Treasury assets	0.1	0.3
Total charge/(release)	**(15.4)**	**9.1**

Impairment releases totalled £15.4m in 2021 compared with a £9.1m charge in 2020.

The group continues to have a low overall level of arrears, reflecting our prudent affordability, credit quality and underwriting standards. The release for the year reflects the more optimistic outlook in relation to the impact of the pandemic on the economy and our mortgage portfolios, following the vaccine roll-out, improved portfolio performance and increased HPI. 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 commercial lending portfolio has experienced a significant reduction in impaired loan balances following loan settlements and improvements in credit quality, which has contributed to the greater comparative release.

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

	2021 £m	2020 £m
Retail mortgage lending	8.3	12.6
Commercial lending	6.4	15.8
Secured personal lending	3.1	5.9
Total	**17.8**	**34.3**

Provisions for liabilities

Regulatory provisions have been made in respect of various customer claims. At 31st December 2021, the group held a provision of £2.7m (2020: £2.8m). 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 19 and 28.

Taxation

The effective tax rate for the group was 23.7% (2020: 20.6%) which is above the statutory rate of 19.0% (2020: 19.0%) due to the additional banking surcharge of 8.0% which is charged on profits over £25m.

A reconciliation of the effective rate to the statutory rate is provided in note 12.

Statement of Financial Position

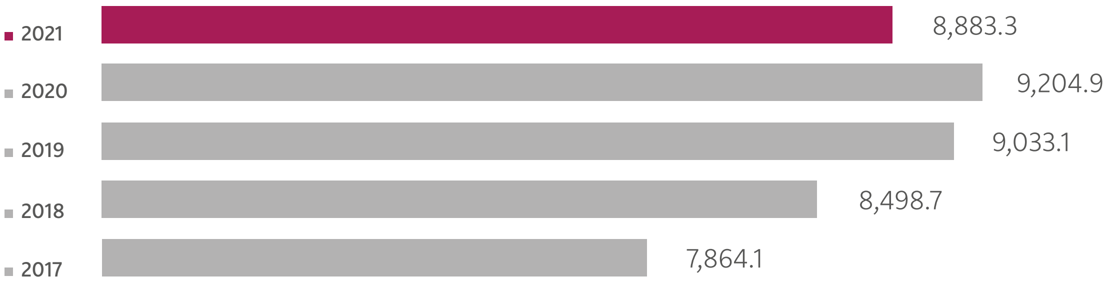
Total assets have reduced to £10,907.9m (31st December 2020: £11,120.9m),as a result of a small reduction in our retail lending book to £8,033.3m (2020: £8,175.7m) whilst we embed our new mortgage system. In addition, the Commercial Lending book reduced to £776.3m (2020: £809.0m), mainly due to expected repayments within the period.

	2017 £m	2018 £m	2019 £m	2020 £m	2021 £m
Liquid assets	1,320.0	1,112.5	1,569.6	1,807.9	1,887.8
Loans and advances to customers	7,864.1	8,498.7	9,033.1	9,204.9	8,883.3
Other assets	78.5	76.2	93.1	108.1	136.8
Total assets	**9,262.6**	**9,687.4**	**10,695.8**	**11,120.9**	**10,907.9**
Retail savings	6,563.8	6,989.8	7,588.5	8,187.4	7,943.7
Wholesale funding	2,035.9	2,019.4	2,378.1	2,200.1	2,262.3
Other liabilities	142.5	127.5	145.8	138.8	55.6
Total liabilities	**8,742.2**	**9,136.7**	**10,112.4**	**10,526.3**	**10,261.6**
Reserves	520.4	550.7	583.4	594.6	646.3
Total liabilities and equity	**9,262.6**	**9,687.4**	**10,695.8**	**11,120.9**	**10,907.9**

Loans and advances to customers

We have continued to focus on our core business of prime lending against residential and commercial property. We have maintained our focus on the implementation of a new mortgage system, which will provide benefits to both brokers and customers. There has been a net decrease in loans and advances to customers of £321.6m (2020: increase of £171.8m) to £8,883.3m (2020: £9,204.9m) due to market conditions, focus on embedding the new mortgage system, a reduction in secured personal lending and expected repayments in the commercial portfolio. Net retail mortgage lending in the year reduced by £142.4m (2020: £182.2m increase). Gross retail mortgage lending was £1,108.4m (2020: £1,266.9m).

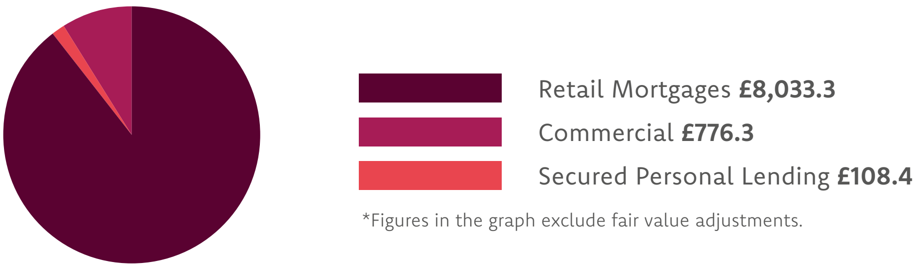
LOANS & ADVANCES TO CUSTOMERS (£M)



The retail mortgage portfolio remains the largest portfolio of the business at £8,033.3m (2020: £8,175.7m). This includes both lending to homeowners and a buy-to-let portfolio of £2,266.5m (2020: £2,269.2m). The support for both residential mortgages and buy-to-let mortgages 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 £108.4m (2020: £141.1m), secured against residential property by a second charge. This business is in run off with balances reducing by £32.7m (2020: £42.7m 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 83% (2020: 78%) of exposures having a loan to indexed valuation of less than 75% and 97% (2020: 94%) 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 30.3% of lending (2020: 30.7%) 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 0.50% (2020: 0.42%) which compares favourably with the industry average of 0.82%[◊]. The marginal increase is due to the removal of government support in 2021. There was an increase in the number of properties taken into possession during the year to 10 (2020: 2) as a result of the moratorium on repossessions in the prior year due to COVID-19.

The percentage of secured personal loans currently in arrears of two months or more by number is 9.19% (2020: 8.35%), which by value is 11.10% (2020: 9.56%). The increase is in part due to the continued run-off of the book as the proportion of customers facing difficulty increases over a smaller book.

The commercial lending portfolio is made up of commercial property exposures representing 35.3% (2020: 36.1%) of balances, and lending against residential property and to registered social landlords of 64.7% (2020: 63.9%). The Society provides loans secured on commercial property across England and Wales, with 46.9% (2020: 46.7%) of lending situated in Wales.

The commercial lending portfolio had one exposure greater than three months in arrears at the year end (2020: five) with a balance of £0.2m (2020: £0.3m). Focus is maintained on all loans experiencing difficulty to ensure positions are tightly managed and the potential for losses arising is realistically and conservatively assessed. Joint action plans are implemented with borrowers wherever possible to minimise the likelihood and extent of defaults.

[◊]UK finance arrears and possession data at 30 September 2021.

Defined benefit pension scheme

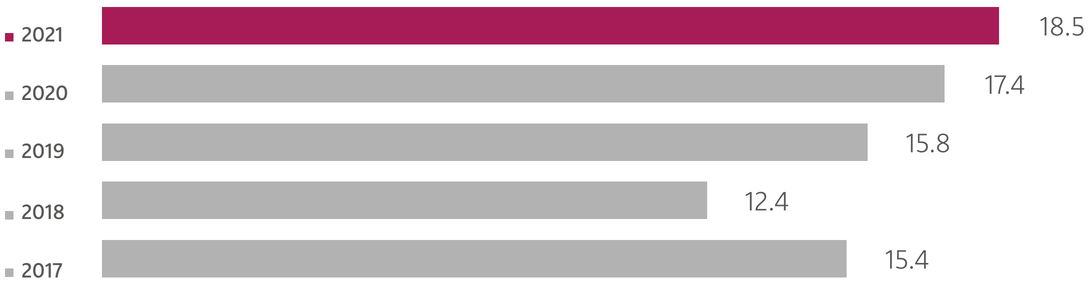
The Society operates a defined benefit pension scheme, which is closed to new entrants and to further accrual. During the year, the pension scheme deficit (the difference between the scheme assets and scheme liabilities on an accounting basis) switched to become a surplus of £3.2m (2020: £2.7m deficit), due largely to returns on the plans assets and an actuarial gain on financial assumptions. The surplus was increased further by contributions made by the Society in the year of £1.6m (2020: £3.1m).

The scheme is subject to a triennial valuation by the scheme's independent actuary. The most recent valuation, with a reference date of 30th September 2019, was completed as planned during 2020. 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 that the pension risk to the Society is appropriately managed.

Liquidity

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 liquid assets at the year end of 18.5% (2020: 17.4%) as a proportion of shares, deposits and loans (SDL). Liquidity levels at the end of the year were higher than anticipated due to the small reduction in our mortgage book during the year, caused by both market conditions and our focus on bedding in our new mortgage system which will benefit both customers and brokers in the near future.

LIQUIDITY RATIO %



Our liquidity is made up of cash and balances with the Bank of England and loans and advances to credit institutions.

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 90.6% (2020: 82.7%). Of the total liquid assets, none (2020: 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 Liquidity Coverage Ratio, a measure of our ability to withstand a short-term liquidity stress, was 293.9% at the year end (2020: 206.8%), 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. Based on current interpretations of the regulation, 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:

	2021 £m	2020 £m
Cash and balances with the Bank of England	1,645.8	1,438.5
Securities issued by the UK Government and Multilateral Development Banks	50.2	69.2
Total Buffer Eligible Assets	**1,696.0**	**1,507.7**
Loans and advances to credit institutions and other debt securities	191.9	318.5
Total	**1,887.9**	**1,826.2**

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 £7,943.8m (2020: £8,187.4m) represent 89.4% (2020: 88.9%) of all mortgage and loan balances. Retail savings balances have decreased by £238.4m in the year (2020: £598.7m increase), as growth in mortgages has reduced slightly over the year.

In January 2021, Friary No. 3 Plc matured, and due to robust levels of liquidity, as well as the Society having access to the Bank of England's TFSME Scheme, no further RMBS issuances were undertaken. The total value of RMBS notes outstanding at the end of the year was £397.6m (2020: £665.6m).

During the year the Society maintained its credit ratings on its long-term and short-term debt with both Moody's and Fitch. Our outlook with both rating agencies improved from negative to stable as a consequence of improved profitability as well as the continued strong performance of the underlying loan portfolios through the COVID-19 pandemic. 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 the Bank of England funding schemes. At the end of the year, 21.7% (2020: 22.7%) of the group's assets were encumbered, representing £2,219.0m (2020: £2,263.4m) of residential mortgage assets and £148.7m (2020: £256.2m) 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 31st December 2021, capital comprises the group's general reserve, adjusted in line with regulatory rules, which qualifies as Common Equity Tier 1 (CET1) capital, the very highest quality of capital.

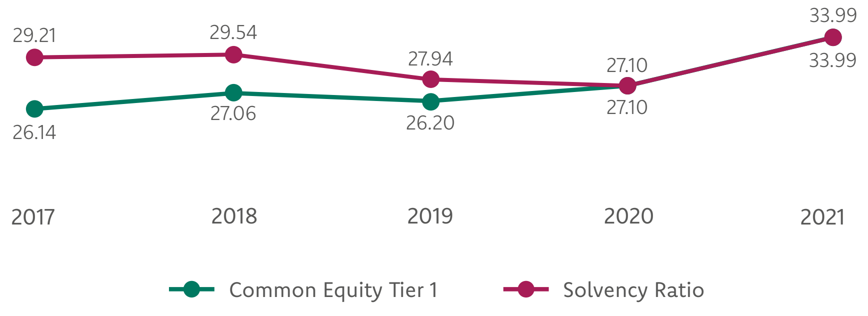
Our primary measure in assessing capital adequacy is the (CET1) ratio, which expresses the highest quality capital as a proportion of the sum of the risk weighted assets of the group. The risk weighting for each asset is calculated either through the use of internal models or through standardised calculations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

Our CET1 ratio has increased to 33.99% in the year (2020: 27.10%). This increase has been driven by increased profits and a reduction in overall balance sheet, as well as a decrease in the level of risk attributed to certain loan assets as a result of house price increases. It currently includes the impact of changes to current capital regulations, which allow for a smaller deduction from capital for intangible assets, however this will be removed in 2022. Removing this change, the CET1 ratio at 31st December 2021 would have been 33.52% (2020: 26.40%).

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 33.99% (2020: 27.10%).

CAPITAL RATIOS %



A further measure of capital strength is the 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 Leverage ratio was 5.56% (2020: 5.14%). This measure is also impacted by the capital regulations mentioned above and would have been 5.45% as at 31st December 2021 (2020: 4.98%) with the changes reversed.

Members, Colleagues and Communities

for the year ended 31st December 2021

Community work

Throughout 2021, we have continued to support and help our local communities. Although the external environment challenges and uncertainties have remained, by working closely with our partners we have been able to maintain our activities in local communities.

Our approach has focused on helping people get a home, health and wellbeing, and financial education (for both Primary and Secondary School pupils). These themes have been in place since 2016, and were probably more relevant than ever given the global pandemic and social challenges.

Health and Wellbeing

Our official charity partners since 2019 have been Teenage Cancer Trust and Alzheimer's Society. Our fundraising for Teenage Cancer Trust is going towards two new Community Nurse posts and with Alzheimer's Society it funded the Dementia Connect Service across Wales. The first Community Nurse will be in post very soon and covers five NHS Health Boards across South / South East Wales, whilst the Dementia Connect Service provides telephone based support to those with dementia, carers and families.

In 2021, we have raised over £58,000 and since the partnership started we have fundraised a total of over £367,000. During 2021, we also went past the significant £1m mark for seven different charity partners since 2014.

We also help a number of other charities each year as part of our Colleague Networks and in 2021 we donated over £4,000 – with recipients including the Size of Wales environmental charity as part of Go Green Day 2021.

Financial education

- In 2021, we have continued to provide opportunities for young people and children to learn about money.
- In 2021, we have continued to provide online learning resources with our Dylan's Den App for children being downloaded over 24,000 times and the launch of a Teachers Hub with learning resources.
- We are so proud to have continued supporting a number of Financial Education charities in 2021. With the London Institute of Banking & Finance a £35,000 Financial Education Fund was set up and this has helped over 500 pupils.
- Partnering with Young Enterprise we proudly sponsored the Fiver Challenge across Wales for the second consecutive year which allowed over 3,000 children to set up their own businesses with £5 of investment.
- In North Wales we have continued to work with the Xplore (STEM) charity in Wrexham, donating £15,000 towards numeracy based workshops for children.

Members

We pride ourselves on listening to our Members so colleagues can understand how to meet their needs and expectations. As part of our commitment to this, in 2021, we evolved our previous Member Panel, to create Member Pulse. This online panel allows us to talk to a diverse Member base, on a frequent basis. The panel now has 1,740 Members, contributing to over 15 discussions, ranging from the future of branches to our social impact strategy - all of which is helping us shape the future strategies of the organisation.

Our thanks goes to all of the Members on our panel for their time and invaluable insight, helping us to shape our Society.

Principality also engages with its Members at the Annual General Meeting where Members have the opportunity to vote and put questions to the Board. Our AGM in 2021 was made available online for our Members to meet government social distancing guidance.

Sponsorship

Due to the COVID-19 pandemic, the events we would normally sponsor, such as the Royal Welsh and Eisteddfod, were sadly cancelled. However, we were really pleased to be a key sponsor and back in person at the Royal Welsh Winter Fair in November 2021. We were thrilled to welcome back crowds to the Stadium again in 2021, where we saw rugby fans reunite for the Autumn Series.

We were finally able to welcome some of our Community Clubs into the Stadium following the difficult times they experienced during the floods of early 2020.

Our people strategy: helping our colleagues to prosper at every stage of their working life

We want Principality to be a fulfilling, collaborative and inclusive place to work as well as an attractive prospect for future colleagues. We're committed to supporting our colleagues to prosper at every stage of their working lives and believe if our colleagues prosper, they will strive to support our Members and our business in the same positive way.

Our people strategy aims to deliver continuous improvements in colleague engagement and satisfaction and is based on the following three elements:

- We will be an employer of choice, continuing to attract and retain talented and passionate people.
- We will inspire a strong customer focused and inclusive culture, investing in our colleagues and building their capability as we transform our Society.
- We will empower our colleagues to live our values, helping them to prosper at every stage of their working lives.

We take pride in creating the right culture

At Principality, we seek to promote a high performing organisational culture encouraging our colleagues to live and demonstrate our values.

The five values that underpin our culture are:

- Being courageous
- Doing the right thing
- Making it straightforward
- Delivering with passion
- Taking ownership

We are dedicated to providing an environment in which our values are recognised and celebrated, where colleagues take pride in how they interact with each other and our Members, and where everyone, regardless of background or experience, feels they belong and can contribute. To continue to build a successful Society, we encourage our colleagues to value and respect each other and our values are a simple mechanism to drive the right culture for our organisation.

Our values are prominent throughout the Society and are recognised through quarterly and annual recognition celebrations. With the on-going challenges in terms of large scale events, all our celebrations were held virtually this year.

Diversity and Inclusion: respecting our colleagues as individuals and building an organisation where everyone belongs

Having a diverse workforce that is representative of the communities we serve is crucial to our ongoing success and we are committed to attracting and retaining colleagues from a diverse spectrum of society. An inclusive workplace where everyone feels they belong and where they can be their authentic selves, is at the core of our inclusion strategy.

Our colleague networks play an important role in supporting this and they have grown organically and now include environment champions, mental health advocates, carers, LGBTQ+ and friends, and REACH (Race, Ethnicity and Cultural Heritage). Alongside these networks, our colleague forum with elected representatives from across the business, is now entering its third year and continues to build on its role of representing the views of colleagues to Senior Leaders and the Board. In 2021, the networks were key to the Society embracing and celebrating events and initiatives such as Pride, World Mental Health Day, National Inclusion Week and Black History Month.

We know that developing and building on diversity and inclusion needs to be done not only in our business but across the financial services sector. We are building our external networks across the UK to support our ambitions and share best practise with others. Part of this included our contribution to the Building Society Association's (BSA) response to the Financial Conduct Authority (FCA), Prudential Regulation Authority (PRA) and Bank of England's discussion paper on the approach to diversity and inclusion within the financial services sector.

We need to ensure that our approach to career progression also supports our ambition to address under-representation at Senior Leadership levels. With this in mind we are starting to track demographic data with regards to secondments and talent programmes.
We continue to be a signatory to HM Treasury's Women in Finance Charter and have set targets for our gender balance in our senior management and Board populations. This year, 30% of our senior positions are filled by women against a target of 33% and we are also proud to have our first female Chair in our history.

Over the past year, we have again worked closely with Stonewall to support all colleagues in feeling comfortable, safe and able to be themselves at work. This included delivering LGBTQ+ Allies training to our Senior Leadership team, and delivering Trans Allies training to our Board and Executive team.

We encourage expertise: investing in our talent to realise potential

We are passionate about developing our colleagues and have a strong learning culture which has a clear focus around supporting colleagues to prosper at every stage of their working lives.

Throughout the business, we have a clear pathway for learning and development at all stages of a colleague's career. Recognising that no two colleagues will approach their development in the same way, our learning offering is accessible in a number of formats and colleagues are able to select from an extensive programme of training to support their role and personal development.

As well as formal courses, we have a varied programme of informal 'lunch and learns' where colleagues are invited to hear from internal and external speakers to boost their skills and knowledge on subjects as varied as climate change and sustainability, financial crime, mental health, diversity, pensions and nature. In a remote learning world these have proved extremely popular and have attracted a number of guest speakers.

STRATEGIC REPORT

Making it easier to do a great job: listening to our colleagues

At Principality, we are proud to have a highly engaged workforce and regularly reach out to colleagues to ensure we drive forward and enhance what we do to ensure we meet their expectations and grow our culture.

Colleague surveys are an important enabler to hearing our colleague voice and for the last five years we have taken part in the annual Great Place to Work® survey which gives all colleagues the opportunity to share their views on working life at the Society. Great Place to Work® is run by an independent third-party and the responses gathered are used to define scores in key outcomes including Engagement, Trust and Wellbeing. We listen and respond to what our colleagues tell us they enjoy about working in our organisation and address feedback around what we can improve. In April we were delighted to find out that we had risen in the ranks in the Great Place to Work® Awards and placed eighth position in the Super Large Workplaces category.

We also hold regular 'Pulse' surveys throughout the year to keep in touch with views and sentiment. The results of all colleague surveys are reviewed in detail and actions developed in response and delivered at both a team and Society-wide level. We have introduced a number of initiatives in a direct response to feedback, including manager training for all people managers, a mentoring scheme and the introduction of colleague specific savings and mortgage products.

Wellbeing

We have a long-established wellbeing approach to promote mental, physical and financial health amongst our colleagues and a wide ranging wellbeing-focussed offering. This includes interventions such as free eye tests and flu vaccinations, an optional private medical care benefit, investment in the workplace, mental health advocates, a round the clock Employee Assistance offering for colleagues and their immediate families and a bespoke wellbeing hub on our internal intranet site.

Since the start of the pandemic in order to ensure colleagues are fully supported, we introduced a range of initiatives to supplement our existing offering, including a weekly corporate fitness programme when gyms were closed, virtual Christmas and summer choirs and informal virtual coffee morning discussions on subjects such as menopause and men's mental health. As well as these, for non-customer facing colleagues, we also introduced a wellbeing hour to ensure they are able to take a break in their working day and monthly 'rejuvenate days' where no formal meetings are to take place.

Rewarding our colleagues fairly

Our people approach means that we treat reward in a fair and consistent manner for all. We are committed to paying the Living Wage and all colleagues are able to participate in our variable pay award scheme. This is linked to a combination of the Society's successes, meeting individual business objectives and our customer experience metrics. We recognise that delivering as a business takes a strong team and our variable pay award scheme has been developed to recognise our combined contribution.

Managing and reducing environmental impacts

At Principality, we fully understand that society as a whole is facing a significant challenge in responding to the risks posed by climate change, and we are committed to playing our part. In 2021 we created the new role of Sustainability Manager to help us understand our current impact on the environment, and to develop a plan of action. The Board also agreed two key targets; the first is to achieve 'net zero' status in our business operations by 2030 and the second is that, until we reach that point, we'll offset our emissions so that we're carbon neutral from 2022. We partnered with a specialist third party, ClimatePartner, to support us with this work.

We recognise that every colleague has a role to play in minimising our carbon emissions and we believe this starts with education. As a result, our colleague-led Environmental Network designed a carbon awareness training programme which they will deliver to all of our colleagues, across both the branch network and our head office, to ensure they understand how their actions impact the planet, and to help empower them to take action.

Energy efficient working environments

Work commenced in 2021 as we invested in the sustainability and redesign of our Head Office, Principality House to make the lighting, heating, cooling, ventilation and power systems more energy efficient through better use of technology.

This year, we also upgraded the lighting in 21 branches by replacing all units with LED technology.

The number of road miles travelled has been measured for the last three years and the table below shows that this has decreased significantly over the last two years, primarily as a result of the pandemic.

Year	Road miles travelled
2019	179,839
2020	36,234
2021	25,779

A proportion of our current leased vehicle fleet runs on diesel fuel so in 2021 we updated our Company Car policy so that as each lease expires replacement vehicles will run either on petrol with a maximum of CO_2 50g/Km or supported by hybrid or fully electric technology.

Reducing waste and recycling effectively

Managing waste effectively is an important area of focus for us. Waste generated at Head Office and across the branch network is separated into general waste, mixed-use recycling, food waste and non-recyclable waste which is then passed to a third party for conversion to energy where possible. Our confidential paper waste is also collected by a specialist third party and recycled.

Energy-efficient technology

We regularly review our technology usage to identify where we can reduce energy consumption. Desktop PCs and laptops continue to be replaced with more energy efficient equipment when required and old equipment is recycled or donated to local charities. We utilise video conferencing technology which is used by colleagues and customers alike to ensure a personal level of service and reducing non-essential travel.

Environmental Champions network

The Environmental Champions Network is a group of almost 50 colleagues from the business, who work together to reduce the impact the Society, its colleagues and members have on the environment.

In addition to designing and delivering a mandatory Carbon Awareness training programme, the network highlights key initiatives, holds awareness events and shares general tips and advice with colleagues for sustainable living. Initiatives delivered in 2021 included providing information about COP26, Earth Day, making sustainable food choices, and how to have a sustainable Christmas.

Environment priorities for 2022

- We will be working with our partners to analyse and understand our carbon footprint in detail, including our scope 3 emissions and will use this to develop a roadmap to achieve our ambition to become net zero by 2030.

- The carbon awareness training programme will continue to run throughout 2022, supported by other activity from the Environmental Network. This will ensure that all our colleagues are provided with a range of information that will help them to live more sustainable lives both at home and at work.

- We will continue to take steps to understand our customers' needs in helping them to understand and manage the risks arising from climate change, particularly our mortgage customers, and we will use this feedback to inform the development of future products and services.

- 2022 should see the completion of the Principality House upgrade and re-design so we hope to welcome our colleagues back to a more carbon efficient and sustainable workplace, which will encourage flexible working and support their wellbeing.

Risk Overview

for the year ended 31st December 2021

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 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 prior years, 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 COVID-19 pandemic:

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.	Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the risk that the Society is unable to access funding markets or to do so only at excessive cost.	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. The path of economic recovery from COVID-19 will continue to have a significant near term impact on the core markets in which we operate, but we also recognise the potential 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

The COVID-19 pandemic has affected the UK economy in many ways. The impact of Government actions such as lockdowns and restrictions on mobility have been severe, and many businesses have failed as a consequence of the significant reduction in general economic activity. The magnitude of the decline in economic output observed in 2020 is unprecedented in modern times, with GDP only reaching pre-pandemic levels in November 2021.Disruption to global supply chains has led to shortages of some goods and products, and firms have increasingly reported difficulties in hiring staff. These factors have led to a slowing of economic growth and a build-up of inflationary pressure. There remains a great deal of uncertainty over the economic outlook, even assuming that further waves of coronavirus do not have a material impact on the economy. Our plans, which are predicated on cautious, realistic assumptions, are tested against a number of alternative scenarios that include a range of plausible outcomes including larger movements in interest rates, increases in unemployment, decreases in residential property values and extreme pressures on certain segments of the commercial real estate market.

(ii) Risk mitigation

The quality of individual lending decisions and subsequent management and control, 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 and assess the potential impact on capital requirements.

(iii) Retail credit risk

We continue to focus on the underlying quality of new lending in the first-charge retail market, ensuring that the mix of overall portfolio exposures remains within our risk appetite. As the effects of the COVID-19 pandemic have eased, we have gradually reversed the temporary restrictions to our lending criteria that were put in place during 2020. We continue to individually underwrite all mortgage applications ensuring that our assessment of creditworthiness 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 is applied to ensure that the proposed mortgage is affordable in the event of future 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, the distribution of gross lending by channel of acquisition 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 and on house price movements.

Our collections and recoveries functions aim to provide a responsive and effective operation for the arrears management process. The emergency payment holiday scheme introduced during the COVID-19 pandemic ended in 2021 and the vast majority of customers who took advantage of this scheme have now returned to making their regular mortgage payments. We encourage early two-way communication with borrowers, with the aim of seeking commitment to maintain payment obligations, typically through repayment plans and alternative forbearance measures. Customers in financial difficulties need support at what may be a difficult time so careful consideration is given to the most appropriate strategy likely to result in the best outcome for the customer and the Society. 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 also subject to a formal annual review. We remain cautious with regard to commercial lending which is undertaken on a prudent basis and continue to adopt a strategy of maintaining long-term relationships. Commercial lending continues to operate within a framework of conservative credit criteria, principally focusing on the underlying income stream and debt servicing cover as well as property value. Whilst we have continued to evaluate new opportunities to lend, we have taken steps to limit our exposure to areas of the commercial lending market that we feel might be less well able to recover from the economic impacts of the pandemic.

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 which 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 exit strategy. In particular the commercial lending division 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

While the UK economic recovery has been strong in 2021, emerging inflationary pressures and related monetary policy responses could result in further market volatility in the near term.

As Bank of England support is tapered and the market predicts quick and successive base rate rises, 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.

The emergence of new COVID-19 variants, and resultant government intervention, also have the potential to drive additional uncertainty in the economy.

(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 August 2021.

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. In addition, as part of its funding strategy, the Society secured £900m of Bank of England funding from the Term Funding Scheme with additional incentives for SMEs (TFSME) prior to the drawdown window closure at the end of October 2021, 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 provision of fixed rate lending and savings products. The various interest rate features and maturity profiles for these products, and the use of wholesale funds to support their delivery, create interest rate risk exposures due to the imperfect matching of interest rates between different financial instruments. Another significant form of interest rate risk arises from the imperfect correlation between re-pricing of interest rates on different assets and liabilities. This is referred to as basis risk.

(ii) Market background and uncertainties

Bank of England (BoE) base rate has remained at a historic low of 10bps for the majority of the COVID-19 pandemic. Bank of England rhetoric regarding the potential use of negative rates at the outset of the pandemic has softened throughout 2021, with an increase in base rate in December 2021 and market pricing in further rate increases over the course of 2022.

While markets expect that the Bank of England's Monetary Policy Committee will begin to tackle inflationary concerns that appear less transitory than initially anticipated, the speed and quantum of changes remains uncertain and near term volatility remains likely.

The London Inter-Bank Offered Rate (LIBOR) will cease to be published after 2021, with the transition to alternative risk free benchmark rates expected to be fully completed shortly thereafter.

(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 has taken all necessary steps to complete a smooth transition of LIBOR-linked Commercial Loans and associated derivative positions in line with regulatory expectations. c£300m of Commercial Loans will be rebased to Bank of England base rate as the final LIBOR fixed period elapses, with transition of the final tranche expected to complete in April 2022. All impacted LIBOR-linked wholesale funding has been rebased to SONIA during 2021. There are two remaining LIBOR-linked derivatives, which will be rebased 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.
Infrastructure and resilience	The risk of loss arising from an inability to service customers and key stakeholders due to a cyber-attack or failure of operational IT infrastructure, including the protection of information from unauthorised access, use, disclosure, modification or destruction.
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, safety and wellbeing	Risks to health, safety and wellbeing 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

COVID-19 will continue to have a near-term impact on our operational risk profile as we manage our way through and out of the pandemic. Whilst the external environment continues to evolve through challenges associated with technological innovation, UK supply chain, increased customer expectations and emerging regulatory standards, the sector is also continuing to deal with the additional operational risk associated with the pandemic. For example, the move to remote working increases the operational risk profile in areas such as data protection, financial crime and third party management. In addition, despite 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. This continues to include activity that exploits the pandemic and the resulting uncertainty arising from these unprecedented circumstances. Our control environment has evolved to protect customers and colleagues and we continue to work collaboratively with industry partners to improve controls and enhance both staff and customer education.

The pandemic has also had a major influence on working lives and has changed employee expectations, in terms of both working patterns and location. The move to remote working has affected the recruitment market and introduced both risks and opportunities in what has become a candidate-led environment.

Despite the ongoing COVID-19 pandemic, we recognise 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.

(ii) Risk mitigation

We manage our exposure to operational risk by assessing the nature of external incidents, information sharing with peer organisations and by the review of internal risk events analysed by reference to the operational risk categories described opposite. 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 crystallisation of operational risks is captured through the recording of risk events including those which result in financial losses or near misses. The analysis of events is used to identify any potential systemic weaknesses in operational processes.

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 IV is adopted.

GDP rebounded in 2021 after the sharp decline experienced in 2020 but the path of economic recovery from COVID-19 remains uncertain as supply chain issues continue to cause inflationary pressures. The Monetary Policy Committee continues to monitor how the end of the Coronavirus Job Retention Scheme flows into labour market data prior to increasing interest rates.

(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 Internal Capital Adequacy Assessment Process (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 Board approved the most recent ICAAP in June 2021.

(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 which may be drawn down in periods of stress, CRD IV 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. This will be published on our website (principality.co.uk) in April 2022.

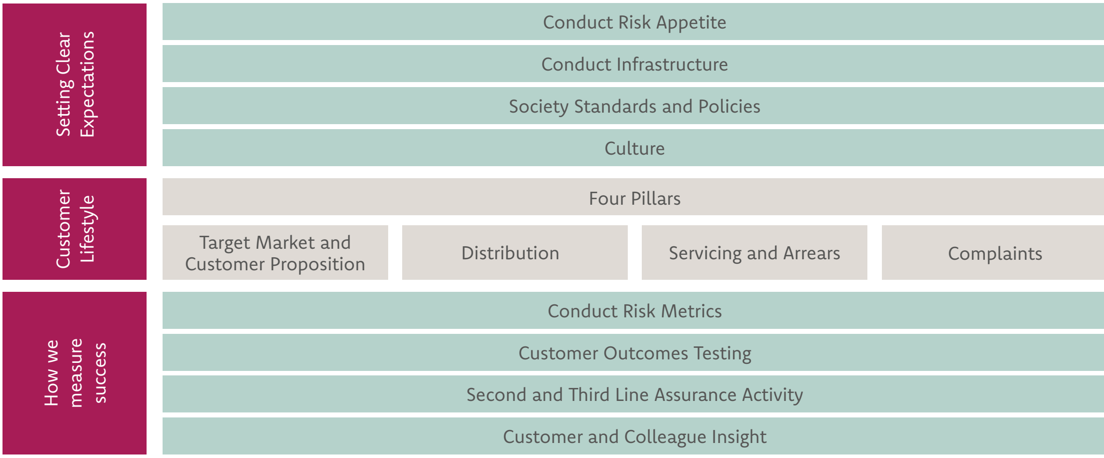
g) Conduct risk

(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. COVID-19 has resulted in a concerted focus by regulators as to how firms can continue to deliver fair outcomes in extremely challenging circumstances, with emphasis on support for mortgage borrowers who face payment difficulties. Our response throughout the COVID-19 crisis to help mortgage customers and savers is aligned with regulatory expectations. Additionally, we are engaged in the industry response to, and implementation of, the Financial Conduct Authority's proposal for a new Consumer Duty, which is designed to bring about a *"fairer, more consumer-focused and level playing field"*.

(ii) Risk mitigation

Our framework for managing conduct risk is outlined in the following diagram:



We have recently taken the opportunity to review and re-launch our Conduct Strategy Framework. The aim of this refresh is to broaden and develop 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 refreshed Conduct Strategy is designed to identify, manage and measure conduct risk by reference to four categories: Customer, Culture, Colleague and Regulatory Conduct, and sets out our strategy for managing conduct risk. The Conduct Strategy also articulates the Board's risk appetite in relation to conduct risk.

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.

Key conduct metrics, which align to our conduct risk appetite and the four pillars outlined above, are reported on a monthly basis to key 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.

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 which 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 'Black Swan' exercises which consider unlikely events that would 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 The nature of our business means that we are inherently exposed to changes in the macroeconomic environment. An economic downturn, for example, has the potential to impact levels of unemployment and consequently the ability of mortgage borrowers to meet their obligations. This, combined with a fall in property values, could result in increased credit losses.	We prepare medium-term financial plans on an annual basis which incorporate scenarios that reflect the impact of changes in the economic environment. Key economic early warning 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, the stress test scenarios published by the Bank of England.

Risk	Mitigating Actions
Current uncertainty in the macroeconomic environment is being driven by a number of factors, the most significant of which is the path of economic recovery from the COVID-19 pandemic, rising inflation and the ongoing impact of the UK's withdrawal from the EU. In addition, there remains significant international geopolitical tensions which have the potential to cause further disruption to the domestic economy.	
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 the onset of the COVID-19 pandemic. These changes are likely to result in continued competition in our core markets, although represent the provision of increased choice for consumers in general. Competitive pressures are expected to increase into the future, particularly as new propositions are developed utilising Open Banking technology.	Our transformation programme is primarily intended to ensure that our core offering remains appropriate and relevant to our target market. The successful delivery of these investment plans will help mitigate the risks arising as a consequence of increased competition. Focus at a Board level has increased in line with the perceived benefits and risks associated with delivery of the project. The markets in which we operate are constantly monitored, to ensure the business can respond to changes in customer requirements.
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) The above risks could manifest as labour markets are disrupted as fossil fuel industries decline and new 'green' labour markets open up, or as homes become a higher flood risk. 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. It is acknowledged that our response will develop as more data and regulatory guidance becomes available and the Society will closely monitor industry developments.

Risk	Mitigating Actions
Operational resilience The nature and pace of technological change represents 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 impact of the pandemic continues to pose challenges to the stability and operational effectiveness of the financial services sector as a whole. The move to remote working because of the COVID-19 pandemic has affected the recruitment market, particularly in the supply of specialist/technical skills needed to support our transformation programme.	Our transformation programme incorporates 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. Management continues to closely monitor the effects of the pandemic on business operations and takes steps as far as possible to mitigate the impact on the provision of services to Members and colleagues alike. Recruitment procedures and our employee offering are under review to ensure we remain competitive and attractive to prospective candidates, monitored through timely management information.
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.

Approval of the Strategic Report

This Strategic Report (on pages 3 to 45) has been approved by the Board of Directors and is signed on behalf of the Board by:

Tom Denman
Chief Financial Officer
21st February 2022

Governance

Board of Directors

Committee Key: **(in bold for Chair)**

AC	Audit Committee	RC	Remuneration Committee	GNC	Governance and Nominations Committee
BRC	Board Risk Committee	TC	Technology Committee		

Sally Jones-Evans

Chair, Non-Executive Director **GNC** RC

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 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 appetite 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 Dyfrydwy 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, a humanitarian and overseas development charity.

Nigel Annett

Non-Executive Director **TC** RC GNC

Joined the Board in October 2013

Skills and experience

I previously worked in investment banking, but after ten years joined the Board of Welsh Water, initially as Planning Director. I was one of the founding Directors of Glas Cymru, the not-for-profit company that took over the ownership of Welsh Water in 2001, and Managing Director of Welsh Water until 2014. I believe strongly that mutual business models can do a great deal of good for the people and the communities that they serve.

Contribution to the Society's long-term sustainable success

I am responsible for ensuring effective oversight of the Society's ongoing transformation programme so that we continue to transform and modernise to benefit both current and future generations of Members.

Other roles

Board member of the Canal and River Trust and a Trustee of the Community Foundation Wales. I sit as a member of the Society's Colleague Forum and it is my role to ensure that the voice of colleagues is heard directly in the Boardroom alongside that of Members.

Claire Hafner

Non-Executive Director

RC AC BRC GNC

Joined the Board in April 2018

Skills and experience

I am a qualified accountant (ACA) and have a 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

I sit as a member of the Society's Colleague Forum and it is my role to ensure that the voice of colleagues is heard directly in the Boardroom alongside that of Members.

Derek Howell

Non-Executive Director

AC BRC GNC

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 both the National Botanic Garden of Wales and Artes Mundi, and a member of the Financial Resources Committee of the St John Ambulance Wales.

David Rigney

Non-Executive Director

BRC AC GNC TC

Joined the Board in March 2015

Skills and experience

I am a Chartered Management Accountant and during my career have performed a broad range of roles across multiple sectors including Board Director at Nationwide Building Society. I believe this experience leaves me well placed to contribute to the Society's ongoing change programme and to contribute to the Society's continuing success.

Contribution to the Society's long-term sustainable success

I am responsible for making sure the Society actively manages the principal risks that arise from its activities, alongside ensuring awareness of the current and emerging risk environment which helps protect the Society so it can continue to be successful and sustainable for its Members.

Other roles

Non-Executive Director at LINK Scheme Holdings Ltd and Senior Independent Director of Elexon Limited.

Debra Evans-Williams

Non-Executive Director

GNC TC 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 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 enables 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

Chair of Local Democracy and Boundary Commission for Wales, Non-Executive Chair of Careers Wales, 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.

Jonathan Baum

Non-Executive Director

AC BRC GNC

Joined the Board in July 2021

Skills and experience

I have 30 years of experience in domestic and international banking within globally renowned organisations including Lloyds Banking PLC Group, Barclays Bank PLC and GE Capital. I was a Non-Executive Director for both 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

Director of Baum Advisory Ltd.

Julie-Ann Haines

Chief Executive Officer (CEO)

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 had almost 20 years' experience leading retail businesses. I was a senior manager in sales, marketing and technology for companies such as Sainsbury's and HBOS PLC. 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, its 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.

Tom Denman

Chief Financial Officer (CFO)

Joined the Board in August 2017

Skills and experience

I am a qualified Chartered Accountant and bring over 20 years' experience in finance to my role. Prior to joining the Society, I held a number of finance roles across a range of industries including commercial property, infrastructure and the legal profession along with five years with PwC in Cardiff and Sydney. I was appointed Deputy Finance Director in March 2016 with responsibility for all of finance, treasury operations, procurement and legal services, and was subsequently appointed CFO in June 2017.

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 line with the long-term interests of our Members and the sustainability of the Society.

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 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 PLC, 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 is aligned to the Society's risk appetite, purpose and objectives.

Other roles

Member of the UK Finance Mortgages Product & Service Board.

Iain Mansfield

Chief Operating Officer (COO)

Joined the Board in December 2019

Skills and experience

I initially joined Principality's subsidiary business, Nemo Personal Finance, as Finance Director in January 2015. In October 2017, I was appointed Chief Operating Officer for the Society. I am a qualified Chartered Accountant and, prior to joining Principality, built 15 years' experience in Senior Leadership roles across large banks, start-up businesses and private equity backed retail financial services businesses.

Contribution to the Society's long-term sustainable success

My role is to ensure we provide excellent service to our customers, maintain and transform our technology, and deliver change effectively and efficiently while maintaining appropriate operational resilience to run our business in the interests of our Members and the sustainability of the Society. I also have responsibility for Commercial Lending and Nemo and in addition, I am also the Executive Sponsor of HTP – our multi year transformation programme.

Corporate Governance Report

for the year ended 31st December 2021

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 possible and relevant to building societies. This report sets out how we have done this during 2021.

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 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.
- Maintaining a sound system of control and setting the Society's appetite for risk. The Board delegates the responsibility for monitoring performance against risk appetite to the Board Risk Committee, and the responsibility for reviewing the adequacy and effectiveness of the Society's internal controls to the Audit Committee.
- Approving significant projects, such as the Society's transformation programme. The Board delegates oversight of this particular programme to the Technology Committee.
- Ensuring that there is an appropriate culture in place across the Society which aligns with its strategy and values. The Chief Executive Officer and the Executive team are responsible for embedding the agreed culture and the Board takes regular steps to assess and ascertain that the Society's culture is fit for purpose.
- 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.
- The Board delegates oversight of these matters to the Governance and Nominations Committee.

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 pack 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 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.
Strategy	• Strategy and Business Model Review • Environmental Strategy • Digital and Data Strategy Review • Medium Term Plan • Corporate Plan • Marketplace Developments • Macro-economic Assumptions • Transformation Programme
Financial Reporting and Performance	• Long-term Viability Statement Review • Annual Report and Accounts and Interim Financial Statements • Letter of Representation to the Auditors • Summary Financial Statement • Quarterly Performance Review • Cost Management update • Capital Expenditure Budget • Budget & Quarterly Reforecasts • On-going COVID-19 Response Planning

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 • Member Talkback and Colleague Forum updates • Remuneration Policy
Risk Management	• Chief Risk Officer Reports • ILAAP and ICAAP • Regulatory Matters • Climate Change Risks • Recovery and Resolution Plan • Approval of Risk Appetite • Information Security and Cyber Resilience • Operational Resilience • Senior Manager Certification Regime and Responsibilities Map • Treasury Policy Statement • Wholesale Funding Decisions • Lending Policies
Governance	• Approval of Board Committee Terms of Reference • Schedule of Matters Reserved to the Board • Board Effectiveness Review (including Action Plan) • Election of Chair • 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 • Common Seal Policy • 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.

Chair: Sally Jones-Evans
Responsible for setting the Board's agenda, leading the Board and ensuring the Board's effectiveness.

Board: 11 Directors
Responsible for the overall conduct of the Society's businesses and setting strategy.

Governance and Nominations Committee Chair:	Board Risk Committee Chair:	Audit Committee Chair:	Technology Committee Chair:	Remuneration Committee Chair:	Chief Executive Officer:
Sally Jones-Evans	David Rigney	Derek Howell	Nigel Annett	Claire Hafner	Julie-Ann Haines

Nemo Personal Finance | **Executive Risk Committee** | **Executive Committee**

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 31st December 2021, the Society's Board comprised the Chair, six independent Non-Executive Directors and four 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, the Board Composition Policy was reviewed and 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 63 to 64.

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.

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 and Committee membership and attendance

	Board	Audit	Board Risk	Remuneration	Technology	Governance and Nominations
Laurence Adams[1]	4/4	-	-	2/2	-	1/1
Sally Jones-Evans	11/11	-	-	5/5	-	5/5
Derek Howell	11/11	7/7	6/6	-	-	5/5
David Rigney	11/11	7/7	6/6	-	5/5	5/5
Nigel Annett	11/11	-	-	5/5	5/5	5/5
Claire Hafner	11/11	7/7	6/6	5/5	-	5/5
Debra Williams	11/11	-	-	3/3	5/5	5/5
Jonathan Baum[2]	5/5	3/3	3/3	-	-	2/2
Julie-Ann Haines	11/11	-	-	-	-	-
Michael Jones	11/11	-	-	-	-	-
Tom Denman	11/11	-	-	-	-	-
Iain Mansfield	11/11	-	-	-	-	-

[1] Resigned from the Board in April 2021.
[2] Joined the Board and Committees in August 2021.

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 six 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.

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 is 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 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 twice a month. 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, three other Executive Directors and three members of the Senior Leadership Team.

Appointments to the Board

Further details about the Non-Executive Director recruitment process can be found in the Report of the Governance and Nominations Committee on pages 63 to 64.

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 2021 AGM.

During the year Michael Borrill stepped down as Secretary after over 30 years of service with the Society. Tony Smith was appointed as Secretary in September 2021.

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. They are likely to stay longer with the Society as a result.

During the COVID-19 pandemic, it has not been possible for Non-Executive Directors to devote a significant amount of time to meeting Members; however, Non-Executive Directors have met with colleagues from across the business virtually as a means of experiencing the culture in the business at first hand. In normal circumstances, by visiting branches, offices and attending meetings of the Member Panel, Colleague Forum, Member Talkback sessions 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 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, albeit virtually during 2021.

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 2021 the following areas were addressed:

- Legal and regulatory developments;
- Corporate governance developments;
- Economic environment;
- Marketplace developments;
- Diversity and inclusion;
- Cyber security;
- IRB model developments and;
- Climate change risks.

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 and for the 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 2021 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 latest review being conducted in the final quarter of 2021. This was performed by Nasdaq who specialise in performing board evaluations. The principal finding arising from 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:

- Further strengthen succession planning and improve Board diversity.
- Further strengthen the Board's culture through both supporting the executive alongside enabling Non-Executive Directors to become more challenging of Executive members of the Board.
- Continuing to improve the quality of MI while reducing the volume of MI.

Progress with work to implement the actions arising from the internally conducted 2021 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.
- How any community and environmental impacts of our operations is considered.
- 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 2021, the Board reviewed its engagement with key stakeholders to ensure that their voices continue to be part of all 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

Key stakeholders	Who they are	How we listen and engage	What they expect from us
Colleagues	Full and part time colleagues	Colleague Forum/LGBTQ+ Forum/REACH/Carers Forum	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 27 to 32	Be a sustainable business and act as a socially responsible organisation

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 report 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, a new role created in 2021 to demonstrate the importance of this topic. This new role's remit includes consideration of how we can support our Members through the risks of climate change as well as understanding, measuring and reporting on our carbon footprint with a view to reducing this to net zero by 2030. More information on this is on page 30 to 32.

The Society also has a growing colleague Environment Network, sponsored by the CEO, who provide advice and practical support not only for other colleagues but also to our local communities. In addition, our investors are keen to ensure they support responsible organisations and we work closely with them to ensure we meet their needs.

The Society has continued to develop our colleague engagement framework further during 2021. As part of this work, Claire Hafner (January 2021 to September 2021) and Nigel Annett (from September 2021) 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 the on-going impact of the COVID-19 pandemic on our colleagues and their wider wellbeing. As part of the work Claire has undertaken during the year, she has also attended a meeting of our LGBTQ+ colleague group and has heard directly from members of that forum about how the Society can become a more inclusive place to work.

The Society is committed to fostering and maintaining good communications with Members. During the year, 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 where possible, or voting by proxy. 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. The 2022 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, subject to prevailing COVID-19 restrictions at that time. It is expected that this hybrid approach will become the standard approach for future AGMs.

All Directors who stood for election or re-election in 2021 were duly elected or re-elected. All Directors will again stand for election or re-election at the 2022 AGM, with the exception of David Rigney who will retire from the Society's Board in March 2022.

Sally Jones-Evans
Chair
21st February 2022

Governance and Nominations Committee Report

for the year ended 31st December 2021

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 2021 comprised all Non-Executive Directors. The Committee met on four occasions during the year.

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, 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 the Miles Partnership LLP (who have no other relationships with the Society) to support the process which led to the appointment of Jonathan Baum 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.

During the year the Committee has:

- Reviewed the size and composition/diversity of the Board and its committees.
- 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.
- 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 2020 internally facilitated review of the Board's own effectiveness and that of its committees.
- This Committee would normally review the mix of the skills and experience of the Board. In 2021, this review was facilitated by an external third party as part of the triennial external Board Effectiveness review with a report on their findings presented to the Board in December 2021.
- 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 2021:

Diversity Target Ratio September 2021	Ratio as at 31st December 2019	Ratio as at 31st December 2020	Ratio as at 31st December 2021
33.3%	31%	31%	30%

At 31st December 2021, 27% (2020: 27%) of Board members were female.

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
21st February 2022

Board Risk Committee Report

for the year ended 31st December 2021

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

Throughout 2021, the Committee comprised three independent Non-Executive Directors, David Rigney, 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 and 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 (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 Committee (CCC)**
  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.

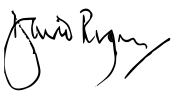
In addition, the Technology Committee (TC), a separate Board Committee, is responsible for providing oversight of the Society's technology transformation programme.

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 & Retail and Commercial Lending Policies • Annual approval of Compliance & 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 & 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.



David Rigney
Chair of the Board Risk Committee
21st February 2022

Audit Committee Report

for the year ended 31st December 2021

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 2021 comprised four independent Non-Executive Directors, Derek Howell (Chair), Sally-Jones Evans (from 1 January 2021 to 31 March 2021), David Rigney, Claire Hafner and with effect from 1 July 2021 Jonathan Baum. The Committee met on seven occasions during the year.

Each Committee member has recent and relevant financial experience in accordance with the 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, the Technology 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:

- **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. As part of this process, the Committee monitors closely the scale of off-balance sheet contingency funding available to the Society and has satisfied itself as to the quality of the assets in which surplus funds are invested. As part of its assessment, the Committee has taken into consideration the impact on the macro-economic environment and the operational impact and key risk areas associated with the continuation of the COVID-19 pandemic. As part of that assessment the Committee has had regard to a range of forward looking macro-economic scenarios.

- **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 group'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. The Committee concluded that the assumptions that are used to inform management's assessment as to the adequacy of impairment provisions remain appropriate. In addition the Committee has continued to monitor carefully the impact of the COVID-19 outbreak on the performance of the Society's loan books and consequent impact on the IFRS 9 impairment provision.

- **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.

- **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.

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. The on-set of more volatile economic conditions has contributed to an increase in the level of volatility in the valuation of hedging instruments in the year. The Committee concluded that the valuation, completeness and appropriateness of hedge accounting remained appropriate in the year.

Assessment of internal controls/oversight of the internal control framework

Good systems of control help to safeguard assets and facilitate the effectiveness and efficiency of day-to-day operations. Management is responsible for establishing and maintaining the control environment. The Committee is responsible for monitoring and ensuring the operating effectiveness of those controls. This work 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 based on the Society's operations. The Committee receives regular reports on the operating effectiveness of the systems and controls framework including financial controls, internal control 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. In addition, the Chief Internal Auditor also has direct access to the Society's Chair. The Committee has held four private meetings with each of the Chief Internal Auditor and Deloitte during the year. 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.

During the year, 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 weakness were identified during 2021.

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 to 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 in to 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.

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.

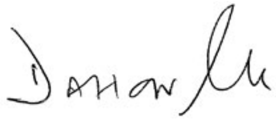
There is periodic rotation of the audit partner responsible for the audit engagement, and each year the external audit firm confirms to the Audit Committee that it considers itself to be independent as defined by the current rules of the Financial Reporting Council. The Society's present audit partner will complete his five year term at the conclusion of the 2021 external audit and will be replaced in 2022.

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 £625k. Non-audit fees, mainly in relation to further assurance services, were £65k.

Other matters

Following each Audit Committee meeting, the Chair of the Committee provides a verbal 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
21st February 2022

Technology Committee Report

for the year ended 31st December 2021

The Technology Committee is responsible for providing oversight of the Society's technology transformation programme ("HTP") and for making recommendations to the Board in respect of any material changes to the programme.

Committee membership

The Technology Committee is a Board Committee and in 2021 comprised three independent Non-Executive Directors, Nigel Annett, David Rigney and Debra Williams following the retirement of Sally Jones-Evans from the Committee in March 2021. The Committee met on five occasions during the year.

The Committee regularly invites members of the Executive team (particularly the Chief Operating Officer, Customer Officer, Chief Risk Officer, Chief Internal Auditor and Chief Financial Officer) to attend its meetings, along with other colleagues from across the business, where appropriate.

Activity during the year

During the year, the Committee has received regular updates from the HTP Executive Sponsor and members of the HTP Senior Leadership team on the progress of the HTP and has provided oversight and challenge on the following matters:

- Key performance indicators relating to cost, time, quality and programme outcomes which are measured against the Board agreed key milestones.

- Assurance reports from second and third line teams.

- Independent external assurance reports received from Credera Limited (formally DMW Group). Credera provides independent assurance on whether the technology transformation programme is being delivered in a manner which is consistent with: the Board agreed business case; clearly defined programme governance; and the strategic direction of the Society.

- Progress with work to enhance the Society's online savings propositions and to improve the experience of Members using the online savings platform.

- Progress with work to complete the phased roll-out of the new mortgage applications processing platform. This work is now expected to be finally completed in H1 2022.

- Progress with work to complete the transition of the HTP savings work-stream into a business as usual change environment.

- The lessons learnt from undertaking the HTP which are applicable to future change/ transformation programmes which might take place in the future.

- Regulatory change which could impact any of the individual components of the transformation programme.
- HTP resource requirements and the continued wellbeing of colleagues who make up the HTP team.
- The methodology which supports the capitalisation of expenditure incurred in respect of the transformation programme.

Other matters

Following each Technology Committee meeting, the Chair of the Committee provides a verbal 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.

Nigel Annett
Chair of the Technology Committee
21st February 2022

Remuneration Committee Report

for the year ended 31st December 2021

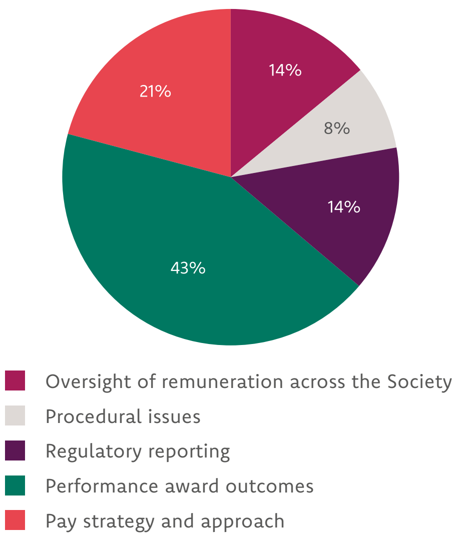
During 2021 changes were made to the membership of the Remuneration Committee. Following the appointment of Sally Jones-Evans into the role of Chair of the Board of Directors, Claire Hafner was appointed as Chair of the Remuneration Committee with effective from 1st August 2021. In line with normal practice, Sally remained a Committee member and Debra Williams also joined the Committee from August. As at 31st December 2021, Committee membership comprised:

- **Claire Hafner** – Chair of the Remuneration Committee and Non-Executive Director
- **Nigel Annett** – Non-Executive Director
- **Sally Jones-Evans** – Chair of the Board of Directors
- **Debra Williams** – Non-Executive Director

A significant proportion of the Committee's time throughout 2021 has been dedicated to:

- Considering the future of reward and ensuring that the Society's variable pay approach is incentivising for Executives, Senior Leaders and all colleagues, as well as responsive to regulatory requirements and reflective of the Society's purpose, giving due regard to diversity and inclusion.
- Setting appropriate pay levels for the Executive-level appointments of Chief Customer Officer and Chief Governance Officer, as well as for Senior Leaders and Material Risk Takers.
- Ensuring fair and competitive provision of benefits for Executives and the wider workforce.
- Overseeing the Society's response to the publication of Capital Requirements Directive V, ensuring the Society has met obligations on extending malus and clawback provisions and reviewing its status as a 'small firm' with regard to the Capital Requirements Regulation.

PROPORTION OF TIME SPENT BY THE REMUNERATION COMMITTEE



In 2021 the position of Remuneration Committee adviser was put to tender. PwC, the incumbent, won the tender and will continue to provide independent advice to the Committee on Executive remuneration and regulatory developments. PwC are also appointed to provide the Society with advice on taxation matters.

Performance in 2021

Performance during the year has been strong from a profit and loss perspective with record levels of profit and underlying profit recorded. High profit levels have been driven by material provision releases due to rising house prices and an improved economic outlook. There has also been significant fair value gain on our interest rate swaps, largely due to rising swap prices which have been impacted by the markets expectations of future rate rises.

Challenging market conditions and the implementation of our new mortgage origination technology, MSO, has resulted in a small reduction in the balance sheet position with reductions in both the savings and mortgage balances. Balancing the needs of our savers whilst remaining competitive in the mortgage market is a constant focus and the savings rates we offer to our Members are directly impacted by the interest we earn on mortgages. Despite this, we still maintained our position as one of the most competitive savings providers on the high street and nine out of ten mortgages continue to be funded by savers.

We remain committed to supporting our Members and this is reflected in our industry leading Net Promoter Score. As a reflection of this we were recently recognised as the Best Building Society - Customer Service by What Mortgage! for the fourth year in a row. As an award voted for by consumers who are asked to rate each UK building society, it is particularly special and is testament to the hard work and commitment of our colleagues.

To ensure that we help people prosper in their homes at every stage of life, we remain committed to building scale, strength and resilience for the future. In doing this we continue our focus on sustainability and the further development of our Diversity and Inclusion strategy to enable positive impact on customers, colleagues and Members.

Remuneration policy

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.
- Support the delivery of "Brilliant People", the central pillar of the overall business strategy.
- Recognise the principles of the Remuneration Code and Corporate Governance Code.

The Remuneration Policy aims to:

- Attract, motivate, reward and retain high quality people who can ensure that Principality continues to deliver value to Members and to be profitable in a competitive and often uncertain marketplace. This is done by positioning all aspects of pay and benefits, both in terms of total amount and structure (i.e. the balance of fixed and variable pay), at around market levels for similar roles within the UK mutual building society sector, as well as more broadly where this is appropriate.
- Promote the right behaviours that align with the Society's 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.
- Incentivise performance and share success by having a competitive variable pay scheme which rewards all colleagues for the achievement of challenging objectives, where performance is judged against a minimum of two critical measures, including a financial measure and a customer measure.

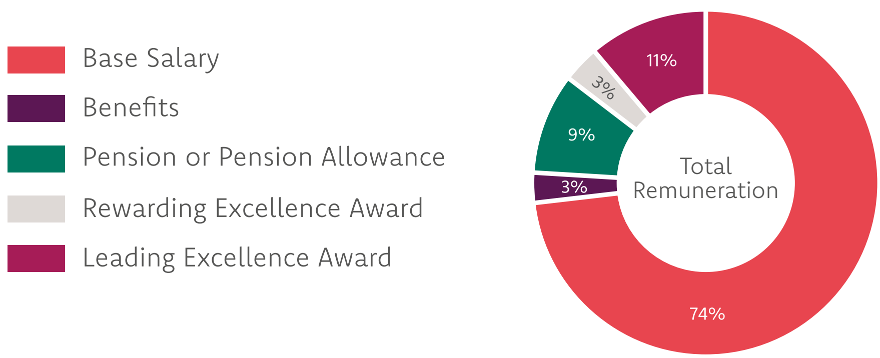
The Remuneration Committee is satisfied that the remuneration policy operated as intended throughout 2021.

How this policy is applied

The table below provides a summary of the different elements of remuneration for Executive Directors in 2021:

Component	Purpose
Base Salary	To attract and retain experienced executives of calibre through the payment of competitive rates. Base salaries are reviewed annually (or more frequently if required).
Benefits	To ensure the Society is acting as a responsible employer and to assist in the performance of the job. Includes private medical insurance, critical illness cover and life assurance, plus legacy car allowance arrangements in some cases that have been phased for new appointments.
Pension or Pension Allowance	To provide for longer-term savings to fund retirement. Pension contribution of 8% of base salary or equivalent cash allowance, or in some cases legacy contributions of 15% that will change to 8% for new appointments.
Rewarding Excellence Award	Designed to share the benefits of teamwork, financial discipline and customer service with all colleagues. Providing a maximum award of 12% of base salary, with annual targets based on risk gateways, profit before tax and customer service measures.
Leading Excellence Award	The Leading Excellence Award (LEA) replaced the Long Term Incentive Plan from January 2019. The Leading Excellence Award is an annual variable pay award with deferral, which has been designed to make setting meaningful targets more effective, enabling the Society to reward, attract and retain our most Senior Leaders. Provides a maximum award of 38% of base salary. Illustration assumes on target LEA award of 19%.

Note: The Chief Risk Officer and the Chief Internal Auditor do not participate in any variable pay scheme.



Each of the elements outlined above are deliberately designed to align with our Remuneration Policy and the characteristics set out in the Corporate Governance Code in respect of clarity, simplicity, risk, predictability, proportionality and alignment to culture.

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.

As detailed below, the performance period for the 2018 Long Term Incentive Plan (LTIP) ended on 31st December 2020, with the last payments made in March 2021. For 2021, variable pay for Executive Directors comprised of the Rewarding Excellence Award (REA) and Leading Excellence Award (LEA).

Rewarding Excellence Award (REA)

The REA is designed to share the benefits of teamwork, financial discipline and customer service with all colleagues across the Society. The two measures of Profit Before Tax (PBT) and the Customer Service Net Promoter Score (Maze NPS) are equally weighted at 50% each once the initial risk gateways are met, to provide a maximum award of 6% of basic salary for each measure, making a total maximum award of 12% of basic salary. The total award for 2021 is 8.72%.

Leading Excellence Award (LEA)

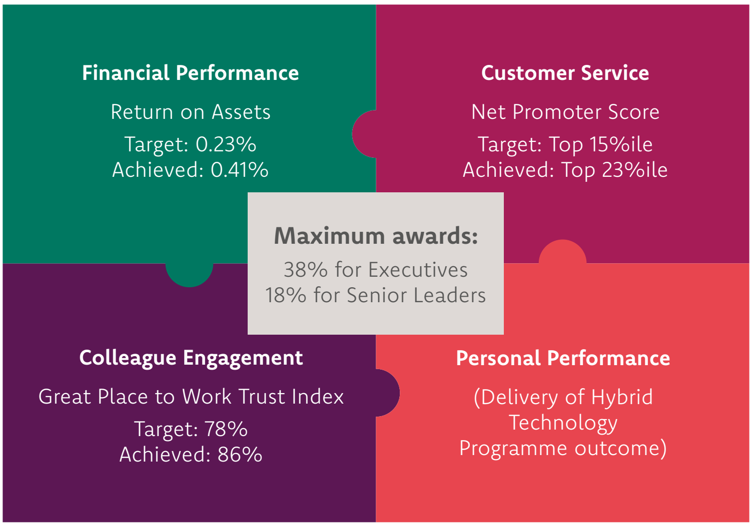
The LEA is an annual incentive scheme for Executives and Senior Leaders, with an element of deferred payment, designed to make setting meaningful targets more effective and therefore enabling the Society to reward, attract and retain our most Senior Leaders over the medium term.

The key features of the LEA are:

1. That it recognises and rewards our Executives and Senior Leaders for their contribution to the long-term goals of the Society.

2. Subject to capital and liquidity gateways, the level of award is determined by performance against four metrics: Financial (Return on Assets), Customer (Ipsos Mori NPS), People (Great Place to Work) and Shared Strategic Business Objective.

3. Performance against these four metrics will determine a percentage factor. For Executives, the range will be 0% to 38% of individual salary, with the on-target award (OTA) being 19% of salary. For Senior Leaders, the range will be 0% to 18% of individual salary, with the OTA being 9% of salary.



The total award for 2021 is 27.23% for Executives and 12.90% for Senior Leaders. 60% of the award is payable in March 2022, with the remaining 40% deferred as follows:

Senior Leaders

2020	2021	2022	2023
Scheme year	60% award payment	40% award payment	
	Scheme year	60% award payment	40% award payment

Executives

2020	2021	2022	2023	2024	2025
Scheme year	60% award payment	20% award payment	20% award payment		
	Scheme year	60% award payment	20% award payment	20% award payment	
		Scheme year	60% award payment	20% award payment	20% award payment

Previous Long-Term Incentive Plan (LTIP)

The LEA replaced the LTIP in 2019, following a full review undertaken by the Remuneration Committee during 2018. A transition period between the two schemes ended in 2020, with the final payment under the LTIP made in 2021, as reported in the 2020 Annual Report.

Annual Report on remuneration

The business complies, where appropriate, with the Corporate Governance Code and aims to make the remuneration policy as transparent, clear and simple as possible. When designing aspects of remuneration, the Committee considers the appropriateness for a Member owned organisation and alignment to our culture, whilst the quantum is carefully positioned to be proportionate to the challenges, encourage the right behaviours and discourage excessive risk taking. We therefore set out in this section the following information:

- Salary increases applied to Executive Directors in 2021
- What the Executive Directors earned for 2021's performance compared to 2020
- CEO pay ratio
- Chair and Non-Executive Director fees in 2021

Salary increases applied to Executive Directors in 2021

It was agreed as part of the pay settlement negotiations in 2020, that Executives and members of the Senior Leadership Team would not receive a base pay increase in the 2021 salary review, except in cases where a market-level adjustment was appropriate. Tom Denman and Iain Mansfield received market level adjustments as shown below. In addition, Iain Mansfield has received a pay increase as of September 2021 to reflect the addition of the Commercial division to his responsibilities. This increase is reflected in the table below.

What Executive Directors earned for 2021's performance

The following table provides the audited information showing a single total figure of remuneration for the 2021 financial year for each of the Executive Directors and compares this figure to the prior year.

Audited Information Individual	Year	Salary & Fees[1] £000	Benefits[2] £000	Pensions[3] £000	Annual variable pay[4 5] £000	Total £000
Chief Executive Officer /Chief Customer Officer Julie-Ann Haines[6]	2021	350	4	28	126	508
	2020	268	10	32	94	404
Interim Chief Executive Officer/ Chief Risk Officer[7] Michael Jones	2021	259	13	39	n/a	311
	2020	307	13	46	n/a	366
Chief Financial Officer Tom Denman	2021	225	12	34	81	352
	2020	224	12	34	78	348
Chief Operating Officer Iain Mansfield	2021	212	12	32	75	332
	2020	204	12	31	72	319

[1] The review date for salary is 1 February 2022.

[2] Benefits comprise a car allowance, life assurance, critical illness insurance and private medical insurance.

[3] A cash allowance of equal value (15% of salary, or 8% of salary for new appointees) may be taken in lieu of pension.

[4] Variable Pay is the total of both the Rewarding Excellence Award and the Leading Excellence Award. In 2020 it also included the 2018 Long Term Incentive Scheme as part of the transitional arrangements. The performance period of the LTIP was three years and the 2018 LTIP operated for the performance period 1 January 2018 to 31 December 2020.

[5] The Chief Risk Officer (and Interim Chief Executive Officer) does not participate in the variable pay scheme.

[6] Julie-Ann Haines was appointed Chief Executive Officer in September 2020. Her 2020 salary was split between her earnings as Chief Customer Officer and Chief Executive Officer.

[7] Michael Jones was appointed Interim Chief Executive Officer in 2020 before Julie-Ann Haines' appointment. His 2020 salary reflects this additional responsibility in 2020.

CEO pay ratio

From 1st January 2019, organisations with over 250 employees are required to disclose the CEO pay ratio in their annual report, in a move to promote transparency and encourage good governance. The CEO pay ratio provides a snapshot of the overall pay gap that exists between the CEO (typically the highest paid person within the organisation) and the average employee in the same organisation and is calculated using the single total figure of remuneration which includes total salary, variable pay, pension and taxable benefits.

The Society has chosen to publish the CEO pay ratio using the recommended and preferred approach (Option A), which shows that the CEO pay is 14 times that of the median colleague pay (this means that when all colleagues' pay is listed from highest to lowest, the median is the middle value in that list):

Year	Method	25th percentile	Median	75th percentile
2021	Option A	20:1	14:1	10:1
2020 (Nominal)	Option A	22:1	15:1	11:1

Our fair pay agenda outlines our commitment to ensuring that reward (including base pay, variable pay and benefits) at Principality is transparent, fair, free from discrimination and aligned to the external market.

In 2018 an in-depth pay and grading review was undertaken, the results of which were introduced to all colleagues in January 2019, providing a future-proofed method of maintaining a direct link between the position of our pay and benefits and the relevant comparators within the financial services sector. This approach is consistently applied to all colleagues across the Society, regardless of position, and was communicated to all colleagues prior to implementation. We are therefore content that the CEO pay ratio is consistent with the Society's wider policies on pay, reward and progression.

Chair and Non-Executive Director fees for 2021

The Society aims to remunerate Non-Executive Directors with fees set at a level that will allow it to attract and retain the required calibre of independent directors. In 2021, the Society commissioned PwC to undertake a review of these fees compared to the external market, and this review indicated that:

- The base fee that the Society pays Non-Executive Directors was below market rate for an institution of its size
- The fee for chairing the Remuneration Committee was similarly below market rate
- The Society was unusual in paying Non-Executive Directors fees for committee membership

In light of this, the Society made adjustments to the fees of Non-Executive Directors, increasing the base fee and removing payment for attending a committee. Incumbent Non-Executive Directors moved to this new structure effective from April 2021 with the exception of Claire Hafner, who remained on the previous structure until regulatory approval of her appointment to Chair of Remuneration Committee was received in August. The fee for this office was brought in line with the market rate at the same time.

Fees paid to the Chairman and the Non-Executive Directors during the year under both structures were as follows:

Audited information Non-Executive Directors	Fees	
	2021 £000	2020 £000
Sally Jones-Evans (Chair of the Board of Directors)[1]	103	63
Nigel Annett CBE (Chair of Technology Committee)	63	63
Derek Howell (Chair of Audit Committee and Senior Independent Director)	73	72
David Rigney (Chair of Board Risk Committee)	68	69
Claire Hafner (Chair of Remuneration Committee)[2]	63	56
Debra Evans-Williams	51	49
Jonathan Baum (from 1st July 2021)	27	-
Laurence Adams (former Chair of Board of Directors - up to 23rd April 2021)	38	121
Total	**486**	**493**

[1] Sally Jones-Evans' 2021 fee increase relates to her appointment as Chair of the Board of Directors.
[2] Claire Hafner's 2021 fee increase relates to her appointment as Chair of the Remuneration Committee.

Looking ahead to 2022

Base salary

The Committee undertakes a review of the Executive Directors' base salaries on 1st 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 2022, it was agreed that Executive Directors would be treated the same way as the wider workforce in terms of salary benchmarking and have the same performance-related increases applied to them. This has resulted in a 3% increase to salaries, as shown below.

Following this review, the Executive Directors salaries will be:

- Julie-Ann Haines £360,500
- Michael Jones £266,396
- Tom Denman £231,750
- Iain Mansfield £231,750

Benefits

No changes have been made to the benefits in kind provided to Executive Directors for 2022. Executive Directors are entitled to receive the following benefits:

- Private medical insurance
- Critical illness cover
- Life assurance
- Some Executive Directors are entitled to a legacy car allowance (this has been phased out for new appointments since 2020)

Pension

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. In 2022, in line with current market practice and to further align with our fair pay agenda across the society, Principality is reviewing pension benefits for the existing Executive Directors who receive a pension contribution of 15% of base salary.

Variable pay

Both the Rewarding Excellence Award (REA) and the Leading Excellence Award (LEA) will continue to operate from 1st January 2022. The committee agreed changes to the structure of the REA for 2022, increasing the number of performance measures from two to three and making adjustments to the weighting of each measure. A summary is set out below:

	Rewarding Excellence Award	Leading Excellence Award
Performance period	1st January 2022 to 31 December 2022.	1st January 2022 to 31 December 2022.
Participants	All colleagues at Principality, except leaders of control functions.	Executives and Senior Leaders, except leaders of control functions.
Administrator	Remuneration Committee.	Remuneration Committee.
Initial gateway requirements	Capital and liquidity conditions and the absence of any material regulatory breaches and achievement of threshold profit before tax	Capital and liquidity conditions and the absence of any material regulatory breaches and achievement of threshold return on assets.
Performance measures	Profit before Tax – 40% Net Promoter Score – 40% Strategic key performance indicator – 20%	Return on Assets – 25% Net Promoter Score – 25% Colleague Engagement – 25% Shared Strategic Business Objective – 25%
Potential payments	Nil for threshold performance. 6% of salary for meeting challenging target performance. 12% of salary for attaining highly stretching targets.	Executives Nil for threshold performance. 19% of salary for meeting challenging target performance. 38% of salary for attaining highly stretching targets. Senior Leaders Nil for threshold performance. 9% of salary for meeting challenging performance targets. 18% of salary for attaining highly stretching targets.

	Rewarding Excellence Award	Leading Excellence Award
Payment date	Subject to Audit and Remuneration Committee approval, payment will be made in March 2023. There will be no partial deferral of payment.	Subject to Audit and Remuneration Committee approval, 60% of the award will be paid to eligible participants in March 2023. Following this, Executives will receive a deferred payment of 20% in March 2024 and a final deferred payment of 20% in March 2025. Senior Leaders will receive a final deferred payment of 40% March 2024.
Clawback (demanding repayment)	The Remuneration Committee can apply clawback to an Executive Director's award - and that of other senior executives and Material Risk Takers - if it is discovered that the award should not have been paid, for example, in the event of a material misstatement of the group's annual results or in the event of a serious regulatory breach.	The Remuneration Committee can apply clawback to an award to an Executive or Senior Leader if it is discovered that the award should not have been paid, in the event of a material misstatement of the group's annual results or in the event of a serious regulatory breach.

The Committee has absolute discretion to adjust the awards under both schemes if necessary, including withholding vested awards under "malus" arrangements or recovering monies paid under clawback. No variable pay awards at the Society are pensionable.

Directors' service contracts

The Chief Executive 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.

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 2020 Director's Remuneration Report are set out below:

Votes for: 19,750	Votes against: 2,031
% in favour 90.68%	% against 9.32%

Approval

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

Claire Hafner
Chair of the Remuneration Committee
21st February 2022

Directors' Report

for the year ended 31st December 2021

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 2021. 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 69 to 73.

Directors

The names of the Directors at the date of this report, together with brief biographical details, are listed on pages 47 to 51. Details of changes affecting the composition of the Board are set out in the Corporate Governance Report on pages 52 to 62. 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 David Rigney, who will retire from the Board in March 2022, 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 23rd April 2021, 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 pages 97 to 98, 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; and

- 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 47 to 51, 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 work carried out by the auditor does not involve consideration of these matters and, accordingly, 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 and the Risk Management Report. The Directors confirm that, to the best of each of their knowledge and belief:

- The financial statements, prepared in accordance with International Financial Reporting Standards 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, and the Risk Management Report includes a description of the principal risks and uncertainties that they face.

GOVERNANCE

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 and the Risk Overview, which include consideration of the on-going impacts from the COVID-19 pandemic. The latter includes:

- Operational changes resulting from the majority of head office colleagues working from home and a transition to a hybrid working approach in 2022.
- Financial and capital impacts from the increased risk of loan losses which may arise if borrowers fall into arrears following the withdrawal of COVID-19 government support schemes.
- Affordability, as a result of high levels of inflation and the actions taken by the Bank of England to address this.
- Outlook for the mortgage and savings markets in the UK and impacts on growth.

Having taken these factors into account, the Directors have a reasonable expectation that the Society can continue in operation and meet its liabilities as they fall due over the three-year period of their assessment. In making this statement, the Directors have considered the resilience of the Society, taking account of its current position, the principal risks facing the business in severe but plausible scenarios, and the effectiveness of any mitigating actions. The assessment has considered the potential impacts of these risks on the business model, future performance, capital adequacy and liquidity over the period.

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 3 to 45.

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 Audit 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 Audit Committee's remit which includes adherence to the Bribery and Conflicts of Interest Policy can be found on the Society's website.

Colleagues

Information relating to employee matters is covered in the Members, Colleagues and Communities report on pages 27 to 32.

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 20 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 9.

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 2021.

Charitable and political donations

In 2021, the Society made donations to charities of £0.2m (2020: £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 31st December 2021 (2020: four 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 2021 meeting alongside receiving the annual Board Whistleblowing Champions Report.

On behalf of the Board of Directors.

Sally Jones-Evans
Chair
21st February 2022

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 31st December 2021 and of the Group's and the Society's income and expenditure for the year then ended;
- have been properly prepared in accordance with United Kingdom adopted international accounting standards; and
- 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; and
- the related notes 1 to 33.

The financial reporting framework that has been applied in their preparation is applicable 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 public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. 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.

FINANCIAL STATEMENTS

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: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used in the Group financial statements was £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 full scope and coverage of 100% of the Group's revenue, profit before tax and net assets.
Significant changes in our approach	The benchmark for determining materiality has changed from 0.3% of net assets in the prior year, to 0.5% of net assets in the current year. The rationale is explained in section 6.1 below. There have been 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; and
- We have tested the historical accuracy of forecasts prepared by management, by comparing historic forecasting to actual results.

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.

Principal risks and viability statement (continued)

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.

IFRS 9 Financial Instruments – Expected Credit Loss provisioning	
Key audit matter description	IFRS 9 is a complex accounting standard which has required considerable judgement, interpretation and modelling complexity to estimate Expected Credit Losses ('ECL') provisions. The models developed estimate the expected loss provisions against loans to customers within the following loan books: • Residential mortgages; • Commercial; and • Secured personal lending. The group held £17.8m of impairment provisions (2020: £34.3m) against total loans and advances to customers of £8,922.3m (2020: £9,142.7m). ECL provisioning is considered a key audit matter as it involves significant judgements taken by management, particularly in light of the COVID-19 pandemic and in particular its impact on economic environment and 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: • Updated Probability of Default ('PD'), Significant Increase in Credit Risk ('SICR') methodology and associated Post Model Adjustments ('PMAs'): the PD and SICR methodology for residential mortgage portfolios has been revised in the year. Management applied PMAs to address known limitations in the revised model including their assessment of the impact of inflation on the Expected Credit Losses (ECL's). Changes made to the model, inclusive of identification of limitations, are considered to be a complex area of statistical modelling and involve a significant level of management judgement. • Commercial PMAs: Management has included a number of PMAs to address model limitations in calculating ECLs in relation to riskier tranches of the Commercial loan book. The identification and assessment of these overlays is subject to significant management judgement.

Key audit matter description	• Macro-economic scenarios, including consideration for COVID-19, 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 applied to each scenario to be incorporated into the ECL model, requires significant judgement to be applied by management. Other material judgements include the estimation of Probability of Default inclusive of the Significant Increase in Credit Risk criteria, loss given default, exposure at default and the other PMAs applied to the models including management's assessment of the impact of cladding legislation and climate risks. ECLs are derived using SAS scripts, which are complex in their nature. Given the material effect of the significant judgements taken by management 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 18. Management's associated accounting policies are detailed on pages 108-118 with detail about judgements in applying accounting policies and critical accounting estimates in pages 118-120. Management's 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 70.
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, the review and approval of macro-economic scenarios and the flow of the output from the model to the general ledger. Our audit procedures to address the risks identified within the loan impairment process included the following procedures below. **Assessment of model assumptions** • With involvement of our internal credit modelling specialists, we challenged whether the updated 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 management's conclusions regarding the appropriateness of the methodology changes. • We challenged the appropriateness of PMAs by assessing whether the PMAs applied adequately address modelling limitations and independently recalculating those which were included. • We have challenged the completeness of retail PMAs by assessing the Group's exposure to the EWS1 legislation as well as management's view on climate risk. To challenge the completeness of the commercial PMAs, we attended the High Risk Exposure Committee to obtain greater understanding of individual commercial watchlist cases, and assessed whether the PMAs capture appropriate credit loss risks present within the commercial loan book.

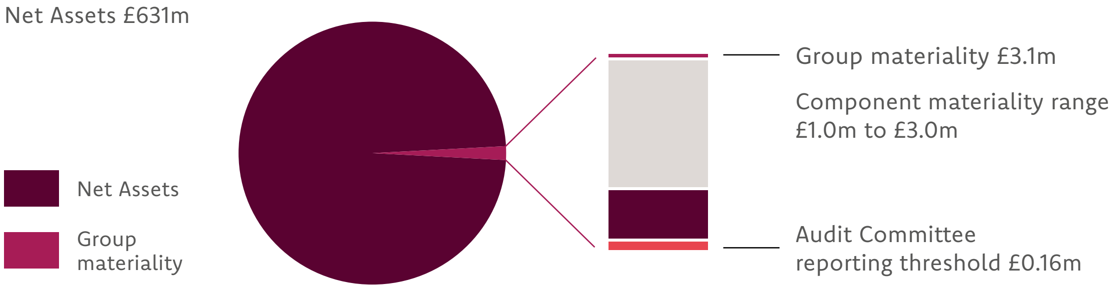
How the scope of our audit responded to the key audit matter	• With involvement of our internal economic modelling specialist, we challenged the macro-economic scenario forecasts that were incorporated into the ECL model. Management's forecasts and probability-weightings were benchmarked against external sources to assess their reasonableness, considering the forecasts in light of Brexit and any contradictory information. • We challenged 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 continued impact of the COVID-19 pandemic. **Assessment of the ECL model** • We evaluated the models and SAS scripts used to derive the ECL provision and assessed their consistency with management's model documentation and their compliance with the requirements of IFRS 9. • We assessed whether changes had been made to management'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** • We tested the data provided by Management 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 environment.
Key observations	Based on our audit procedures above, we concluded that management'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	£3.1m (2020: £2.0m)	£2.4m (2020: £1.3m)
Basis for determining materiality	0.5% of net assets (2020: 0.3% net assets)	0.5% of net assets (2020: 0.3% 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 business and net assets is understood to be regulatory capital, which is of significant interest for users of the financial statements including regulators. In 2021, we used 0.5% of net assets as the benchmark for determining materiality. This aligns the materiality for the Society with peers. The key reason for the change in the factor of materiality from 0.3% in 2020 to 0.5% in 2021 is due to the change in the macroeconomic environment which is less uncertain in the current year and the Society's profitability is recovering back to that of pre-COVID-19 times. As a result we no longer consider it appropriate to apply a materiality cap in the current year. As such, we apply a 0.5% factor to net assets to determine materiality for the group and the Society. This change in benchmark has been communicated and agreed with the Audit Committee.	



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% (2020: 70%) of group materiality	70% (2020: 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, despite the operational challenges imposed by COVID-19; b) The moderate and isolated level of prior-year uncorrected and corrected misstatements and the likelihood of 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 £0.16m (2020: £0.10m), 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% (2020: 100%) of the Group's revenue, profit before tax and net assets. There are 5 components in the Group. 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 £1.0m to £2.6m (2020: £1.0m to £1.4m).

Our consideration of the control environment

A controls reliance strategy over the lending and savings cycles was planned and taken. We obtained an understanding of and tested the controls within these cycles. In order to test controls, a combination of re-performance, inquiry, observation and/or inspection was performed on a sample basis, tailored to the nature and timing of each control. We obtained an understanding of and tested the IT systems surrounding the above cycles.

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: www.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 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 and the Financial Conduct Authority; 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; and
- 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 89 to the Financial Statements for the financial year ended 31st December 2021 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 is set out on page 88;
- the Directors' explanation as to its assessment of the Group's prospects, the period this assessment covers and why the period is appropriate is set out on page 86-89;
- the Directors' statement on fair, balanced and understandable is set out on page 86;
- the Board's confirmation that it has carried out a robust assessment of the emerging and principal risks is set out on page 87;
- the section of the annual report that describes the review of effectiveness of risk management and internal control systems is set out on page 66; and
- the section describing the work of the Audit Committee is set out on page 69.

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 27th April 2007 to audit the financial statements for the year ending 31st December 2007 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 15 years, covering the years ending 31st December 2007 to 31st December 2021.

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.

K. J. Cooper

Kieren Cooper FCA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Birmingham, United Kingdom
21st February 2022

Consolidated income statement *for the year ended 31st December 2021*

	Notes	2021 £m	2020 £m
Interest receivable and similar income	4	198.7	205.6
Interest payable and similar charges	5	(69.5)	(97.0)
Net interest income		129.2	108.6
Fees and commission receivable	6	3.9	4.1
Fees and commission payable		(1.8)	(2.1)
Net fee and commission income		2.1	2.0
Other operating income		0.8	0.7
Other fair value gains/(losses)	7	9.6	(4.1)
Net operating income		**141.7**	**107.2**
Administrative expenses	8	(79.8)	(70.9)
Depreciation and amortisation	21 & 22	(10.8)	(9.0)
Other impairment losses	21 & 22	(2.5)	–
Operating expenses		(93.1)	(79.9)
Impairment provision release/(charge) on loans and advances	18	15.4	(9.1)
Provision for liabilities	19	–	1.7
Operating profit and profit before taxation		**64.0**	**19.9**
Taxation expense	12	(15.2)	(4.0)
Profit for the year		**48.8**	**15.9**

Consolidated statement of other comprehensive income

	Notes	2021 £m	2020 £m
Profit for the year		48.8	15.9
Items that will not be reclassified subsequently to profit and loss:			
Actuarial gain/(loss) on retirement benefit obligations	11	4.3	(5.7)
Tax (credit)/charge on retirement benefit obligations	12	(1.0)	1.1
Items that may be reclassified subsequently to profit and loss:			
Loss on fair value through other comprehensive income		(0.4)	(0.1)
Tax charge on fair value through other comprehensive income	12	–	–
Total comprehensive income for the year		**51.7**	**11.2**

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 108 to 174 form part of these accounts.

Income statement of the Society *for the year ended 31st December 2021*

	Notes	2021 £m	2020 £m
Interest receivable and similar income	4	190.5	196.2
Interest payable and similar charges	5	(69.5)	(96.7)
Net interest income		121.0	99.5
Fees and commission receivable	6	3.9	4.1
Fees and commission payable		(1.7)	(2.1)
Net fee and commission income		2.2	2.0
Other operating income		0.8	0.7
Other fair value gains (losses)/gains	7	(0.8)	5.5
Net operating income		**123.2**	**107.7**
Administrative expenses	8	(79.1)	(70.5)
Depreciation and amortisation	21 & 22	(10.8)	(9.0)
Other impairment losses	21 & 22	(2.5)	-
Operating expenses		(92.4)	(79.5)
Impairment provision release/(charge) on loans and advances	18	13.0	(9.7)
Provision for liabilities	19	0.6	0.5
Operating profit and profit before taxation		**44.4**	**19.0**
Taxation expense	12	(13.6)	(1.8)
Profit for the year		**30.8**	**17.2**

Statement of other comprehensive income of the Society

	Notes	2021 £m	2020 £m
Profit for the year		30.8	17.2
Items that will not be reclassified subsequently to profit and loss:			
Actuarial gain/(loss) on retirement benefit obligations	11	4.3	(5.7)
Tax (credit)/charge on retirement benefit obligations	12	(1.0)	1.1
Items that may be reclassified subsequently to profit and loss:			
Loss on fair value through other comprehensive income		(0.4)	(0.1)
Tax charge on fair value through other comprehensive income	12	-	-
Total comprehensive income for the year		**33.7**	**12.5**

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 108 to 174 form part of these accounts.

Consolidated statement of financial position *as at 31st December 2021*

	Notes	2021 £m	2020 £m
Assets			
Liquid assets:			
Cash in hand and balances with the Bank of England		1,645.8	1,438.5
Loans and advances to credit institutions	13	165.8	290.7
Debt securities	14	76.3	78.7
		1,887.9	1,807.9
Derivative financial instruments	15	52.8	23.7
Loans and advances to customers:			
Loans fully secured on residential property		8,598.2	8,897.7
Other loans		285.1	307.2
	16	8,883.3	9,204.9
Intangible fixed assets	21	26.0	25.4
Property, plant and equipment	22	36.6	36.5
Investment properties	22	6.2	6.5
Deferred tax assets	27	2.3	2.3
Retirement benefit	11	3.2	–
Other assets		–	4.4
Prepayments and accrued income		9.6	9.3
Total assets		**10,907.9**	**11,120.9**
Liabilities			
Shares	23	7,943.8	8,187.4
Deposits and debt securities:			
Amounts owed to credit institutions	24	1,296.2	1,026.2
Amounts owed to other customers		270.1	201.3
Debt securities in issue	25	696.0	972.6
		2,262.3	2,200.1
Derivative financial instruments	15	24.7	106.2
Current tax liabilities		0.8	1.1
Other liabilities	26	11.3	17.1
Provision for liabilities	19	2.7	2.8
Accruals and deferred income		10.6	7.2
Deferred tax liabilities	27	5.4	1.7
Retirement benefit obligations	11	–	2.7
Total liabilities		10,261.6	10,526.3
General reserve		645.5	593.4
Other reserves		0.8	1.2
Total equity and liabilities		**10,907.9**	**11,120.9**

The accounting policies and notes on pages 108 to 174 form part of these accounts. These accounts were approved by the Board and authorised for issue on 21st February 2022.

Sally Jones Evans
Chair

Julie-Ann Haines
Chief Executive Officer

Tom Denman
Chief Financial Officer

Statement of financial position of the Society *as at 31st December 2021*

	Notes	2021 £m	2020 £m
Assets			
Liquid assets:			
Cash in hand and balances with the Bank of England		1,645.8	1,438.5
Loans and advances to credit institutions	13	93.7	199.3
Debt securities	14	76.3	78.7
		1,815.8	1,716.5
Derivative financial instruments	15	50.1	23.6
Loans and advances to customers:			
Loans fully secured on residential property		8,489.8	8,756.6
Other loans		285.1	307.2
	16	8,774.9	9,063.8
Investments in subsidiary undertakings	20	0.1	24.0
Intangible fixed assets	21	26.0	25.4
Property, plant and equipment	22	36.0	35.9
Investment properties	22	6.2	6.5
Deferred tax assets	27	2.2	2.2
Retirement benefit	11	3.2	–
Other assets		–	4.4
Prepayments and accrued income		9.6	9.3
Total assets		**10,724.1**	**10,911.6**
Liabilities			
Shares	23	7,943.8	8,187.4
Deposits and debt securities:			
Amounts owed to credit institutions	24	1,622.1	1,601.3
Amounts owed to other customers		270.1	201.3
Debt securities in issue	25	298.4	307.0
		2,190.6	2,109.6
Subsidiary liability	20	16.0	–
Derivative financial instruments	15	23.8	97.2
Current tax liabilities		0.8	–
Other liabilities	26	11.3	17.1
Provision for liabilities	19	0.7	1.3
Accruals and deferred income		10.1	6.8
Deferred tax liabilities	27	5.3	1.5
Retirement benefit obligations	11	–	2.7
Total liabilities		10,202.4	10,423.6
General reserve		520.9	486.8
Other reserves		0.8	1.2
Total equity and liabilities		**10,724.1**	**10,911.6**

The accounting policies and notes on pages 108 to 174 form part of these accounts. These accounts were approved by the Board and authorised for issue on 21st February 2022.

Sally Jones Evans
Chair

Julie-Ann Haines
Chief Executive Officer

Tom Denman
Chief Financial Officer

Statement of changes in Members' interests *for the year ended 31st December 2021*

	2021			2020		
	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	593.4	1.2	594.6	582.1	1.3	583.4
Comprehensive income for the year	52.1	(0.4)	51.7	11.3	(0.1)	11.2
At 31 December	**645.5**	**0.8**	**646.3**	**593.4**	**1.2**	**594.6**
Society						
At 1 January	486.8	1.2	488.0	474.2	1.3	475.5
Comprehensive income for the year	34.1	(0.4)	33.7	12.6	(0.1)	12.5
At 31 December	**520.9**	**0.8**	**521.7**	**486.8**	**1.2**	**488.0**

The group's capital at 31st December 2021 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 31st December 2021*

	2021 £m	2020 £m
Net cash flows from operating activities (see below)	372.8	443.8
Cash flows from investing activities		
Purchase of intangible assets	(5.7)	(9.7)
Purchase of property, plant and equipment	(7.7)	(6.5)
Purchase of investment securities	(8.7)	(53.4)
Proceeds from sale and maturity of investment securities	10.7	139.9
Net cash flows from investing activities	**(11.4)**	**70.2**
Cash flows from financing activities		
Interest paid on subscribed capital	–	(1.7)
Interest paid on debt securities in issue	(11.1)	(15.7)
Proceeds from issuance of debt securities in issue	1.1	28.9
Redemption of debt securities in issue	(268.0)	(139.7)
Repayment of lease liabilities	(1.0)	(1.2)
Repayment of subscribed capital	–	(60.0)
Net cash flows from financing activities	**(279.0)**	**(189.4)**
Increase in cash and cash equivalents	82.4	324.7
Cash and cash equivalents at the beginning of year	1,729.2	1,404.5
Cash and cash equivalents at the end of year	**1,811.6**	**1,729.2**
Represented by:		
Cash and balances with the Bank of England	1,645.8	1,438.5
Loans and advances to credit institutions repayable on demand	165.8	290.7
	1,811.6	**1,729.2**
Cash flows from operating activities		
Profit before taxation	64.0	19.9
Adjusted for:		
Depreciation and amortisation	10.8	9.0
Charge on defined benefit scheme	–	0.1
Impairment on loans and advances to customers	(15.4)	9.1
Impairment on fixed assets	1.5	–
Impairment on intangible assets	1.0	–
Change in fair values	99.8	(40.0)
Release of other provisions	–	(1.7)
Interest on debt securities in issue	10.8	14.6
Interest on subscribed capital	–	1.7
Non-cash items included in profit before tax	(0.4)	0.8
Changes in net operating assets		
Loans and advances to customers	223.1	(134.1)
Other operating assets	0.9	(3.0)
Derivative financial instruments	(110.6)	53.4
Shares	(238.4)	596.1
Deposits	338.8	(71.8)
Other operating liabilities	(2.1)	(2.5)
Contributions paid into defined benefit scheme	(1.7)	(3.1)
Taxation paid	(9.3)	(4.7)
Net cash flows from operating activities	**372.8**	**443.8**

Statement of cash flows of the Society *for the year ended 31st December 2021*

	2021 £m	2020 £m
Net cash flows from operating activities (see below)	121.8	327.6
Cash flows from investing activities		
Purchase of intangible assets	(5.7)	(9.7)
Purchase of property, plant and equipment	(7.7)	(6.5)
Purchase of investment securities	(8.7)	(53.4)
Proceeds from sale and maturity of investment securities	10.7	139.9
Net cash flows from investing activities	**(11.4)**	**70.3**
Cash flows from financing activities		
Interest paid on subscribed capital	–	(1.7)
Interest paid on debt securities in issue	(7.7)	(7.1)
Repayment of lease liabilities	(1.0)	(1.0)
Repayment of subscribed capital	–	(60.0)
Net cash flows from financing activities	**(8.7)**	**(69.8)**

Increase in cash and cash equivalents	101.7	328.1
Cash and cash equivalents at the beginning of year	1,637.8	1,309.7
Cash and cash equivalents at the end of year	**1,739.5**	**1,637.8**
Represented by:		
Cash and balances with the Bank of England	1,645.8	1,438.5
Loans and advances to credit institutions repayable on demand	93.7	199.3
	1,739.5	**1,637.8**
Cash flows from operating activities		
Profit before taxation	44.4	19.0
Adjusted for:		
Depreciation and amortisation	10.8	9.0
Charge on defined benefit scheme	–	0.1
Impairment on loans and advances to customers	(13.0)	9.7
Impairment on fixed assets	1.5	–
Impairment on intangible assets	1.0	–
Change in fair values	99.8	(40.0)
Release of other provisions	(0.6)	(0.5)
Interest on debt securities in issue	7.7	7.1
Interest on subscribed capital	–	1.7
Non-cash items included in profit before tax	0.5	0.5
Changes in net operating assets		
Loans and advances to customers	187.9	(173.1)
Decrease in loans to subsidiary companies	23.9	44.6
Increase in loans from subsidiary companies	16.0	–
Other operating assets	2.0	(4.6)
Derivative financial instruments	(99.9)	42.4
Shares	(238.4)	596.1
Deposits	89.7	(178.6)
Other operating liabilities	(2.0)	(0.2)
Contributions paid into defined benefit scheme	(1.7)	(3.1)
Taxation paid	(7.8)	(2.5)
Net cash flows generated from operating activities	**121.8**	**327.6**

Notes to the accounts *for the year ended 31st December 2021*

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 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16: Interest Rate Benchmark Reform - Phase 2 have been adopted in the year with a mandatory effective date of 1st January 2021.

The amendments focus on the accounting for the replacement of existing benchmark interest rates, and provide relief by allowing entities:

- not to recognise significant modification gains or losses on financial instruments if a change results directly from LIBOR reform and occurs on an 'economically equivalent' basis; and

- continue existing hedging relationships despite changes to hedge documentation for modifications required as a direct consequence of LIBOR reform.

During 2021, the process to transition all GBP LIBOR linked loans and associated swaps to a new benchmark rate has been taking place and the group has made use of the accounting reliefs available, subject to the relevant criteria being met.

As at 31st December 2021, the group does have loan advances to Commercial lending customers and associated interest rate swaps linked to GBP LIBOR, which are included in macro and micro fair value hedge relationships. However all LIBOR linked swaps and lending will either mature or be moved to a new benchmark rate by the end of Q1 2022. Further disclosure is provided in note 15.

Adoption of other amendments to existing standards and annual improvements applicable in 2021 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.

1. Accounting policies (continued)

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. 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.

1. Accounting policies (continued)

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.

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.

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.

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 below:

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.

1. Accounting policies (continued)

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.

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.

1. Accounting policies (continued)

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.

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.

1. Accounting policies (continued)

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%
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 31st July 2010.

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

Significant increase in credit risk

As described in note 1 on page 108, one of the primary tests for determining whether a loan has experienced a significant increase in credit risk is 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.

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

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 being 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	3.1	0.1	2.3
Stage 2 to stage 1	(0.4)	(0.0)	(0.3)

Retail IFRS 9 model changes

During 2021, 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 a restatement of the Long Run Probability of Defaults (LRPD) used within the Expected Credit Loss (ECL) calculations. These changes have resulted in a decrease in modelled provisions of £3m.

The revised ERM has been built based on the relationship between the chosen economic variables and arrears and defaults volumes observed historically. Given the unprecedented nature of the current downturn and the risk that the future relationship between economic variables and default volumes may not mirror past events, a Post Model Adjustment (PMA) has been applied to the modelled outputs to add greater stress sensitivity to the downturn PDs. This PMA effectively assumes that forecasted downturn default volumes will increase in line with unemployment forecasts and restricts the impact of any other economic variables that reduce the downturn PDs. The ECL impact of applying this PMA is £0.5m.

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 10% from migrating to stage 2 unless the customer is in arrears. This captures 3,170 accounts, representing 4.05% 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.

Post model adjustment - fuel inflation

It has been widely reported that energy prices are rising and will continue to increase; the cause of this impact has already occurred but customers will not feel the full effects until after the Governments' energy price cap is reset in April, as a result the model does not currently reflect this risk. A PMA of £1.3m has been provided to address the risk that these increased fuel costs, combined with increasing inflation rates, may cause some customers to fall into arrears and eventually default. The PMA is based on customers with a loan to income (LTI) at origination of 4.45 and above. The PMA is calculated by uplifting the ECL for those customers to the average non-arrears stage 2 ECL. Lowering the LTI threshold to 4.35 would increase the PMA by £0.7m.

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 18.

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 11.

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.

	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**
	2020			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	84.3	15.3	9.0	108.6
Other income & charges	1.1	1.6	–	2.7
Fair value loss	(4.1)	–	–	(4.1)
Net operating income	**81.3**	**16.9**	**9.0**	**107.2**
Operating expenses	(77.1)	(2.5)	(0.3)	(79.9)
Impairment provision for losses on loans & advances	(2.0)	(7.7)	0.6	(9.1)
Provision for liabilities	0.6	–	1.1	1.7
Operating profit and profit before taxation	**2.8**	**6.7**	**10.4**	**19.9**
Taxation expense				(4.0)
Profit after taxation				**15.9**

3. Business segments (continued)

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

	Group	
	2021 £m	2020 £m
Total assets by business segments		
Retail financial services	10,008.5	10,141.0
Commercial lending	774.9	838.7
Secured personal lending	124.5	141.2
Total assets	**10,907.9**	**11,120.9**
Total liabilities & equity by business segment		
Retail financial services & Commercial lending	10,783.4	10,979.7
Secured personal lending	124.5	141.2
Total liabilities & equity	**10,907.9**	**11,120.9**

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	
	2021 £m	2020 £m	2021 £m	2020 £m
On loans fully secured on residential property	213.1	219.2	203.5	206.7
On other loans	9.9	11.5	9.9	11.5
On loans to subsidiaries	-	-	1.4	3.5
On debt securities	0.8	1.1	0.8	1.1
On other liquid assets	1.5	2.9	1.5	2.5
On derivative financial instruments	(26.6)	(29.1)	(26.6)	(29.1)
	198.7	**205.6**	**190.5**	**196.2**

5. Interest payable and similar charges

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
On shares held by individuals	58.7	81.8	58.7	81.8
On deposits and debt securities	14.6	21.0	18.8	24.2
On subscribed capital	-	1.7	-	1.7
On lease liabilities	0.3	0.2	0.2	0.2
On derivative financial instruments	(4.1)	(7.7)	(8.2)	(11.2)
	69.5	**97.0**	**69.5**	**96.7**

6. Fees and commission receivable

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Insurance & related financial service products	0.9	1.1	0.9	1.1
Mortgage related fees	3.0	3.0	3.0	3.0
	3.9	**4.1**	**3.9**	**4.1**

7. Other fair value gains and losses

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Gains/(losses) on derivatives in hedging relationships	107.0	(41.3)	107.0	(41.3)
Gains/(losses) on derivatives not in hedging relationships	2.3	(2.8)	(8.1)	6.8
Gains/(Losses) on derivatives	**109.3**	**(44.1)**	**98.9**	**(34.5)**
Gains on economic hedged items	5.9	7.2	5.9	7.2
(Losses)/gains on hedged items attributable to the hedged risk	(105.6)	32.8	(105.6)	32.8
(Losses)/gains on hedged items	**(99.7)**	**40.0**	**(99.7)**	**40.0**
	9.6	**(4.1)**	**(0.8)**	**5.5**

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.

8. Administrative expenses

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Wages and salaries	41.4	35.8	41.4	35.8
Social security costs	3.7	3.8	3.7	3.8
Other pension costs	2.5	2.4	2.5	2.4
	47.6	**42.0**	**47.6**	**42.0**
Other administrative expenses	32.2	28.9	31.5	28.5
	79.8	**70.9**	**79.1**	**70.5**

	Group		Society	
	2021 £000	2020 £000	2021 £000	2020 £000
Other administrative expenses include:				
Auditor's remuneration				
For audit of the Society's Annual Accounts	524	384	524	384
For audit of the Society's subsidiaries	101	96	–	–
Total	625	480	524	384
For other services				
Further assurance services	65	66	65	66
Total other services	65	66	65	66

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

9. Employees

The average number employed including Executive Directors was:

	Full-time		Part-time	
	2021 Number	2020 Number	2021 Number	2020 Number
Society's Customer Support Centre and administration office	675	691	125	99
Society branches	185	206	119	114
Employed by the group	**860**	**897**	**244**	**213**

10. 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 of Building Societies (Accounts and Related Provisions) Regulations 1998. Total Directors’ emoluments for the year were £1.9m (2020: £1.9m).

11. 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 1st 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 2021 was £2.5m (2020: £2.4m). 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 1st 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 31st 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 1st January 2001.

The defined benefit scheme was subject to a triennial valuation by the scheme’s independent actuary on 30th September 2019. This valuation was completed in October 2020.

The defined benefit scheme closed to future accruals on 31st 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.

During the year £1.7m was paid into the pension scheme from the Society (2020: £3.1m). There are no further agreed contributions to be paid by the Society in 2022. 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 6th 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 £32.8m (2020: £37.1m).

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

	At 31st December				
	2021 %	2020 %	2019 %	2018 %	2017 %
Rate of increase of pensions in payment:					
CPI 3%	2.40	2.10	1.95	2.25	2.20
CPI 5%	2.80	2.40	2.15	–	–
CPI 3% fixed	–	3.00	–	–	–
Discount rate	1.80	1.30	2.00	2.80	2.40
Inflation assumption (RPI)	3.35	2.95	3.00	3.20	3.20
Inflation assumption (CPI)	2.80	2.40	2.15	2.20	2.20

The assumptions used for the valuation at 31st December 2021 take into account the estimated impact of the RPI reforms from 2030 and will be reviewed at least annually as more information becomes available.

The assumptions on mortality are determined by the following tables:

	2021	2020
Retired and non-retired members	S3NA CMI 2020 LTR 1.25%	S3NA CMI 2019 LTR 1.25%
The assumptions are illustrated by the following years of life expectancy at age 60:		
Retired Members		
Males currently aged 60	26.7	26.9
Females currently aged 60	29.5	29.5
Non-retired Members		
Males currently aged 40	28.1	28.4
Females currently aged 40	30.9	31.0

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

	At 31st December				
	2021 £m	2020 £m	2019 £m	2018 £m	2017 £m
Target return funds	-	-	-	-	29.0
Multi asset	46.7	40.2	36.5	29.0	-
LDI	9.6	11.7	8.5	6.7	-
Annuities	24.7	26.0	25.5	23.9	25.9
Bonds and cash	3.7	4.8	3.8	3.4	8.5
Total fair value of plan assets	**84.7**	**82.7**	**74.3**	**63.0**	**63.4**
Present value of funded obligations	(81.0)	(84.9)	(73.8)	(66.4)	(71.8)
Present value of unfunded obligations	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Net surplus/(deficit) recognised in the statement of financial position	**3.2**	**(2.7)**	**-**	**(3.9)**	**(8.9)**

During the year, the pension scheme deficit switched to a surplus at the end of the year, primarily as a result of returns on plan assets and an actuarial gain on financial assumptions. The surplus was further increased by the £1.7m of contributions paid into the pension scheme by the Society during 2021.

The actual gain on plan assets was £3.6m during the year (2020: £8.0m).

11. Retirement benefit obligations (continued)

Defined benefit scheme (continued)

The amounts recognised in the income statement are as follows:

	Group and Society	
	2021 £m	2020 £m
Analysis of the amounts recognised in the income statement		
Interest on pension scheme assets	(1.1)	(1.5)
Interest on pension scheme liabilities	1.1	1.5
Net interest expense	**-**	**-**
Past service cost	-	0.1
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	2.5	6.5
Experience (losses)/gains on liabilities	(0.1)	1.1
Gains/(losses) from changes to demographic assumptions	0.2	(0.4)
Gains/(losses) from changes to financial assumptions	1.7	(12.9)
Total remeasurement	**4.3**	**(5.7)**
Analysis of the movement in the statement of financial position deficit		
Deficit in scheme at beginning of year	(2.7)	-
Movement in year:		
Net interest expense	-	-
Remeasurements	4.3	(5.7)
Contributions paid and accrued	1.6	3.1
Past service cost	-	(0.1)
Surplus/(deficit) in scheme at end of year	**3.2**	**(2.7)**
Analysis of the movement in the fair value of pension scheme assets		
Fair value of assets at the beginning of the year	82.7	74.3
Interest on assets	1.1	1.5
Society contributions	1.7	3.1
Benefits paid	(3.3)	(2.6)
Return on plan assets less interest	3.8	5.9
Change in fair value of the annuity policy	(1.3)	0.5
Fair value of assets at the end of the year	**84.7**	**82.7**
Analysis of the movement in the present value of the pension scheme liabilities		
Present value of liabilities at the beginning of the year	85.4	74.3
Interest expense	1.1	1.5
Remeasurement losses/(gains):		
Actuarial gains & losses arising from changes in demographic assumptions	(0.2)	0.4
Actuarial gains & losses arising from changes in financial assumptions	(1.7)	12.9
Actuarial gains & losses arising from experience adjustments	0.1	(1.1)
Benefits paid	(3.2)	(2.6)
Past service cost	-	-
Present value of liabilities at the end of the year	**81.5**	**85.4**

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	(6.8)	6.8
Inflation	6.7	(6.7)
Life expectancy (+1 year/-1 year)	3.9	(3.9)

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.

12. Taxation

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Current tax				
UK corporation tax charge for the year	12.2	5.2	10.5	3.2
Adjustments in respect of prior years	0.5	(1.4)	0.6	(1.6)
	12.7	3.8	11.1	1.6
Deferred tax				
Deferred tax charge for year	2.4	(1.6)	2.4	(1.6)
Adjustments in respect of prior years	0.1	1.8	0.1	1.8
	2.5	0.2	2.5	0.2
Taxation expense	**15.2**	**4.0**	**13.6**	**1.8**

The statutory rate of corporation tax has remained at 19% during 2021 and is expected to remain at 19% through 2022. As profits have exceeded £25m in 2021, the additional banking surcharge of 8% applies to all profits above the limit.

12. Taxation (continued)

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	
	2021 £m	2020 £m	2021 £m	2020 £m
Profit before taxation	64.0	19.9	44.4	19.0
Profit multiplied by the statutory rate of corporation tax at 19.0% (2020: 19.0%)	12.2	3.7	8.4	3.6
Effects of				
Impact of banking surcharge at 8.0%	1.5	–	1.5	–
Impact of rate change	0.9	–	0.9	–
Expenses not deductible for tax purposes	–	–	0.1	–
Adjustments to prior years	0.6	0.3	0.7	(1.8)
Timing differences	–	–	2.0	–
Taxation on profit from ordinary activities	**15.2**	**4.0**	**13.6**	**1.8**

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	
	2021 £m	2020 £m	2021 £m	2020 £m
Current tax				
Relating to retirement benefit obligations	(0.3)	(0.8)	(0.3)	(0.8)
	(0.3)	(0.8)	(0.3)	(0.8)
Deferred tax				
Relating to retirement benefit obligations	1.3	(0.3)	1.3	(0.3)
Gain on fair value through other comprehensive income	–	–	–	–
	1.3	(0.3)	1.3	(0.3)
Total charged to other comprehensive income	**1.0**	**(1.1)**	**1.0**	**(1.1)**

13. Loans and advances to credit institutions

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Loans and advances to credit institutions	165.8	290.7	93.7	199.3

Included in the above amount for the group is £76.7m of collateral given under Credit Support Annex (CSA) agreements (2020: £164.8m).

14. Debt securities

	Group and Society	
	2021 £m	2020 £m
Issued by other borrowers and unlisted	26.1	27.8
Issued by Supranational entities	50.2	50.9
	76.3	**78.7**

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

The movement in debt securities is summarised as follows:

	Group and Society	
	2021 £m	2020 £m
At 1st January	78.7	165.1
Additions	8.7	53.4
Disposals and maturities	(10.7)	(139.9)
(Losses)/gains from changes in fair value	(0.4)	0.1
At 31 December	**76.3**	**78.7**

15. 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	
	2021 £m	2020 £m	2021 £m	2020 £m
Derivative assets:				
Interest rate swaps	3,282.6	1,416.8	52.8	23.7
Total recognised derivative assets	**3,282.6**	**1,416.8**	**52.8**	**23.7**
Derivative liabilities:				
Interest rate swaps	2,755.4	4,950.9	24.7	106.2
Total recognised derivative liabilities	**2,755.4**	**4,950.9**	**24.7**	**106.2**

	Society			
	Contract/notional amount		Fair Value	
	2021 £m	2020 £m	2021 £m	2020 £m
Derivative assets:				
Interest rate swaps	3,560.7	2,265.1	50.1	23.6
Total recognised derivative assets	**3,560.7**	**2,265.1**	**50.1**	**23.6**
Derivative liabilities:				
Interest rate swaps	3,157.9	5,091.9	23.8	97.2
Total recognised derivative liabilities	**3,157.9**	**5,091.9**	**23.8**	**97.2**

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	
	2021 £m	2020 £m	2021 £m	2020 £m
Derivatives				
Total derivatives in economic hedge relationships				
Interest rate swaps	266.2	370.7	946.8	1,360.1
Total derivatives used as fair value hedges				
Interest rate swaps	5,771.8	5,997.0	5,771.8	5,997.0
Derivative assets in economic hedge relationships				
Interest rate swaps	200.7	-	200.7	-
Derivative assets used as fair value hedges				
Interest rate swaps	3,081.9	1,416.8	3,360.0	2,265.1
Derivative liabilities in economic hedge relationships				
Interest rate swaps	65.5	370.7	65.5	370.7
Derivative liabilities used as fair value hedges				
Interest rate swaps	2,689.9	4,580.2	3,092.4	4,721.2

15. 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	
	2021 £m	2020 £m	2021 £m	2020 £m
Fair value hedges				
Micro hedges				
Commercial loans	104.1	112.9	104.1	112.9
Wholesale	300.0	300.0	300.0	300.0
FV adjustment on hedged item (asset)	8.1	(1.7)	8.1	(1.7)
FV adjustment on hedged item (liability)	(8.9)	5.2	(8.9)	5.2
Macro hedges				
Residential and commercial loans	4,670.0	4,456.0	4,670.0	4,456.0
Retail savings	680.9	1,097.0	680.9	1,097.0
FV adjustment on hedged item (asset)	111.8	(39.0)	111.8	(39.0)
FV adjustment on hedged item (liability)	(5.4)	2.7	(5.4)	2.7
Other underlying adjustments				
Amortisation/unwinds	(5.6)	(7.2)	(5.6)	(7.2)

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Hedging strategy outcome				
Micro hedge – asset				
Commercial loans – hedged items	8.1	(1.7)	8.1	(1.7)
Commercial loans – hedged instruments	(6.5)	3.3	(6.5)	3.3
Micro hedge – liability				
Wholesale – hedged items	(8.9)	5.2	(8.9)	5.2
Wholesale – hedged instruments	8.9	(5.2)	8.9	(5.2)
Macro hedge – asset				
Residential and commercial loans – hedged items	111.8	(39.0)	111.8	(39.0)
Residential and commercial loans – hedged instruments	(114.8)	46.1	(114.8)	46.1
Macro hedge – liability				
Retail savings – hedged items	(5.4)	2.7	(5.4)	2.7
Retail savings – hedged instruments	5.4	(2.9)	5.4	(2.9)
Economic hedge items				
Amortisation/unwinds	(5.9)	(7.2)	(5.9)	(7.2)
Economic hedge instruments				
Dedesignation	(0.3)	(0.3)	(0.3)	(0.3)
Economic hedges – awaiting designation	(1.9)	2.1	(1.9)	2.1
Economic hedges – securitisation	–	–	10.4	(9.6)

The Society's fair value gains and losses shown in the previous table 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 31st 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
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 31st 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
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**

15. Derivative financial instruments (continued)

Group **As at 31st December 2020**	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	–	–	5.7	48.4	76.4	130.5
PIBS & EMTN interest rate swaps	–	–	–	300.0	–	300.0
Macro hedge						
Retail mortgages interest rate swaps	30.0	248.0	518.0	3,565.0	20.0	4,381.0
Commercial interest rate swaps	2.8	–	11.3	47.6	38.4	100.1
Savings interest rate swaps	65.0	58.0	496.0	477.0	–	1,096.0
Economic hedges						
Retail mortgages interest rate swaps	–	–	–	205.0	155.0	360.0
Commercial interest rate swaps	–	–	–	–	–	–
Savings interest rate swaps	–	–	–	–	–	–
	97.8	**306.0**	**1,031.0**	**4,643.0**	**289.8**	**6,367.6**

Society **As at 31st December 2020**	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	–	–	5.7	48.4	76.4	130.5
PIBS & EMTN interest rate swaps	–	–	–	300.0	–	300.0
Macro hedge						
Retail mortgages interest rate swaps	30.0	248.0	518.0	3,565.0	20.0	4,381.0
Commercial interest rate swaps	2.8	–	11.3	47.6	38.4	100.1
Savings interest rate swaps	65.0	58.0	496.0	477.0	–	1,096.0
Economic hedges						
Retail mortgages interest rate swaps	–	–	–	205.0	155.0	360.0
Commercial interest rate swaps	–	–	–	–	–	–
Savings interest rate swaps	–	–	–	–	–	–
Securitisation interest rate swaps	–	–	141.0	848.3	–	989.3
	97.8	**306.0**	**1,172.0**	**5,491.3**	**289.8**	**7,356.9**

Interest Rate Benchmark Reform

Throughout the year, the LIBOR transition programme, under the governance of the Chief Financial Officer, has ensured that the Society transitions its current LIBOR exposures, including Commercial loans linked to LIBOR, to an alternative benchmark rate by the end of 2021. As at 31st December 2021, there are only two LIBOR linked swaps and £335.9m of Commercial LIBOR linked loans. All of which will either mature or move to an alternative benchmark rate in the first quarter of 2022.

Contract/notional amount of financial instruments affected by benchmark reform		Loans and advances to customers	Derivative financial instruments
Current benchmark	**Future benchmark**		
GBP LIBOR	Bank of England base rate	335.9	–
GBP LIBOR	Sterling Overnight Indexed Average (SONIA)	–	4.8
		335.9	4.8

FINANCIAL STATEMENTS

16. Loans and advances to customers

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Fully secured on residential property	8,637.2	8,835.4	8,528.0	8,691.9
Fully secured on land	285.1	307.3	285.1	307.3
	8,922.3	**9,142.7**	**8,813.1**	**8,999.2**
Provision for impairment losses	(17.8)	(34.3)	(14.7)	(28.4)
Effective Interest Rate adjustments	13.5	17.3	11.2	13.8
Fair value adjustment for hedged risk	(34.7)	79.2	(34.7)	79.2
	8,883.3	**9,204.9**	**8,774.9**	**9,063.8**

Retail financial services & Secured personal lending

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

Stage	31st December 2021 %	31st December 2020 %
1	86	86
2	13	13
3	1	1

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

Staging reason	31st December 2021 %	31st December 2020 %
PD grade deterioration	96	93
30-60 days past due	3	7
Forbearance	-	-

Commercial

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

Stage	31st December 2021 %	31 December 2020 %
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	31st December 2021 %	31st December 2020 %
Risk grade deterioration	99	93
30-60 days past due	1	7

17. 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 31st December 2021, the encumbrance ratio was 21.7% (31st December 2020: 22.7%). All other assets are defined as unencumbered.

An analysis of the group's encumbered and unencumbered on-balance sheet assets as at 31st December 2021 and 2020 is set out below.

	2021		2020	
	Encumbered £m	Unencumbered £m	Encumbered £m	Unencumbered £m
Cash in hand & balances at the Bank of England	-	1,645.8	-	1,438.5
Loans and advances to credit institutions	76.6	89.2	164.8	125.9
Debt securities	-	76.3	-	78.7
Derivative financial instruments	-	52.8	-	23.7
Loans and advances to customers	2,291.1	6,592.2	2,354.7	6,850.2
Other assets	-	83.9	-	84.4
Total	**2,367.7**	**8,540.2**	**2,519.5**	**8,601.4**

18. Provision for impairment losses

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**

18. Provision for impairment losses (continued)

Group 2020	Retail £m	Commercial lending £m	Secured personal lending £m	Total £m
New loans	1.0	0.6	-	1.6
Settled loans	(1.0)	(1.5)	(0.6)	(3.1)
Changes in model assumptions	(0.6)	-	(0.8)	(1.4)
Changes in credit quality	2.2	8.7	0.8	11.7
Balance sheet impact	**(1.6)**	**(7.8)**	**0.6**	**(8.8)**
(Utilisation)/recoveries	**(0.4)**	**0.1**	**-**	**(0.3)**
Income statement impact	**(2.0)**	**(7.7)**	**0.6**	**(9.1)**

Provision for impairment losses at 31st December 2021 include £17.8m for loan loss provisioning impairment (2020: £34.3m) and £1.1m on other debt instruments (2020: £0.9m). Total ECL coverage as at 31st December 2021 was 0.14% (2020: 0.22%) in respect of retail financial services and secured personal lending and 0.72% in respect of commercial lending (2020: 1.95%). Changes in model assumptions for 2021 include the model changes and PMAs discussed in note 2.

Also included within provision for impairment losses is £0.4m (2020: £0.3m) 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 2021	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1st 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	(2,486.2)	(319.8)	(33.3)	(2,839.3)
Gross loan balance at 31st December 2021	**8,063.2**	**1,189.0**	**67.0**	**9,319.2**

18. Provision for impairment losses (continued)

Society 2021	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1st 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	(2,449.9)	(306.3)	(29.3)	(2,785.5)
Gross loan balance at 31st December 2021	**8,006.2**	**1,151.2**	**53.0**	**9,210.4**

Group 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1st January 2020	8,792.0	655.7	49.2	9,496.9
Transfers:				
Stage 1 transfers	(603.7)	-	-	(603.7)
Stage 2 transfers	-	573.3	-	573.3
Stage 3 transfers	-	-	30.4	30.4
New loans	1,317.8	88.1	0.6	1,406.5
Settled loans	(968.9)	(51.4)	(8.1)	(1,028.4)
Repayments	(246.8)	(29.4)	(0.8)	(277.0)
Gross loan balance at 31st December 2020	**8,290.4**	**1,236.3**	**71.3**	**9,598.0**

Society 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1st January 2020	8,657.3	620.8	39.0	9,317.1
Transfers:				
Stage 1 transfers	(585.7)	-	-	(585.7)
Stage 2 transfers	-	562.3	-	562.3
Stage 3 transfers	-	-	23.5	23.5
New loans	1,317.8	88.1	0.6	1,406.5
Settled loans	(950.5)	(48.2)	(6.6)	(1,005.3)
Repayments	(235.3)	(26.4)	(0.3)	(262.0)
Gross loan balance at 31st December 2020	**8,203.6**	**1,196.6**	**56.2**	**9,456.4**

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

Group 2021	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1st 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 31st 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 1st 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 31st December 2021	**3.1**	**8.3**	**3.3**	**14.7**

Group 2020	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1st January 2020	3.7	15.8	6.1	25.6
Transfers:				
Stage 1 transfers	(0.8)	–	–	(0.8)
Stage 2 transfers	–	8.4	–	8.4
Stage 3 transfers	–	–	4.7	4.7
New loans	0.9	0.7	0.1	1.7
Settled loans	(0.9)	(1.4)	(0.8)	(3.1)
Changes in credit quality	1.1	(2.5)	0.6	(0.8)
Changes in model assumptions	1.1	(2.3)	(0.2)	(1.4)
Loss allowance at 31st December 2020	**5.1**	**18.7**	**10.5**	**34.3**

Society 2020	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1st January 2020	3.5	11.9	3.6	19.0
Transfers:				
Stage 1 transfers	(0.8)	–	–	(0.8)
Stage 2 transfers	–	8.9	–	8.9
Stage 3 transfers	–	–	3.1	3.1
New loans	0.9	0.7	0.1	1.7
Settled loans	(0.8)	(1.2)	(0.5)	(2.5)
Changes in credit quality	1.2	(1.9)	0.3	(0.4)
Changes in model assumptions	1.1	(1.5)	(0.2)	(0.6)
Loss allowance at 31 December 2020	**5.1**	**16.9**	**6.4**	**28.4**

The following tables show an analysis of expected credit losses by PD band and the average provision coverage within each PD band as at 31st December 2021.

Retail and Secured personal lending	2021		2020	
	Sum of ECL £m	Coverage %	Sum of ECL £m	Coverage %
0.00% - 0.11%	0.9	0.02	-	0.01
0.11% - 0.17%	0.9	0.05	0.3	0.02
0.17% - 0.25%	0.7	0.06	0.6	0.03
0.25% - 0.41%	0.5	0.07	1.1	0.05
0.41% - 0.60%	0.3	0.08	1.0	0.09
0.60% - 0.88%	0.4	0.15	1.3	0.20
0.88% - 1.49%	0.4	0.27	2.0	0.50
1.49% - 2.96%	0.4	0.57	1.4	0.95
2.96% - 6.84%	0.3	1.15	0.6	1.26
6.84%+	6.7	6.15	10.3	7.78
Total	**11.4**		**18.5**	

Commercial lending	2021		2020	
	Sum of ECL £m	Coverage %	Sum of ECL £m	Coverage %
PD:				
0.28%	0.1	0.1	0.2	0.1
0.56%	0.3	0.1	0.3	0.1
1.13%	0.8	0.3	0.9	0.3
2.25%	1.3	0.8	1.9	1.0
4.50%	1.8	3.1	2.7	3.7
9.00%	1.1	8.9	4.7	17.3
18.00%	0.1	3.0	0.5	8.5
36.00%	0.1	16.6	0.3	14.5
100.00%	0.9	11.3	4.4	32.3
Total	**6.4**		**15.8**	

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 2022 to December 2026:

GDP Growth %	Scenario	Weighting at 31st 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**

Unemployment (Absolute)	Scenario	Weighting at 31st 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 31st 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**

The equivalent scenarios and weightings for the period ending 31st December 2020 were as follows:

GDP Growth %	Scenario	Weighting at 31st December 2020 %	2021	2022	2023	2024	2025
	Base	32.5	8.8	8.0	5.1	2.8	2.5
	Upside	30.0	13.0	7.3	5.9	3.7	2.6
	Downside	23.0	4.7	8.3	5.1	3.1	2.6
	Severe downside	14.5	(0.1)	6.4	3.8	2.3	2.3
	Weighted average		**7.8**	**7.6**	**5.2**	**3.1**	**2.5**

18. Provision for impairment losses (continued)

Unemployment (Absolute)	Scenario	Weighting at 31st December 2020 %	2021	2022	2023	2024	2025
	Base	32.5	7.8	6.8	6.0	5.5	5.3
	Upside	30.0	6.8	5.7	5.1	4.8	4.7
	Downside	23.0	8.8	8.0	7.0	6.3	5.9
	Severe downside	14.5	10.5	10.2	8.9	8.1	7.4
	Weighted average		**8.1**	**7.3**	**6.4**	**5.9**	**5.6**

HPI %	Scenario	Weighting at 31st December 2020 %	2021	2022	2023	2024	2025
	Base	32.5	(8.1)	2.3	6.9	6.7	4.1
	Upside	30.0	(1.6)	7.5	6.7	5.8	4.0
	Downside	23.0	(12.5)	3.0	8.9	9.3	6.3
	Severe downside	14.5	(20.2)	(3.9)	6.1	10.3	9.4
	Weighted average		**(8.9)**	**3.1**	**7.2**	**7.6**	**5.3**

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.

Portfolio	Upside £m	Severe downside £m	ECL Range £m
Retail financial services	2.4	10.1	7.7
Secured personal lending	2.1	5.0	2.9
Commercial lending	3.2	6.2	3.0

19. Provision for liabilities

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
At 1st January	2.8	4.4	1.3	1.7
Charge for the year	-	0.1	0.1	0.1
Release during the year	(0.1)	(1.7)	(0.7)	(0.5)
At 31st December	**2.7**	**2.8**	**0.7**	**1.3**

At 31st December 2021, the group held a provision of £2.7m (2020: £2.8m) 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.

20. Investments in subsidiary undertakings

	Society	
	2021 £m	2020 £m
Shares in subsidiary undertakings	0.1	0.1
Loans to subsidiary undertakings	-	23.9
	0.1	**24.0**

	Subsidiary undertakings	
	Shares £m	Loans £m
Movement in investments in subsidiary undertakings:		
At 1st January 2021	0.1	23.9
Loan repayment	-	(23.9)
At 31st December 2021	**0.1**	**-**

	Society	
	2021 £m	2020 £m
Surplus cash received from subsidiaries	16.0	-
	16.0	**-**

FINANCIAL STATEMENTS

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 and Friary No.6 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. All remaining funding via Friary No.3 PLC was repaid in January 2021 and the entity has now been liquidated.

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 28th 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. 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

21. Intangible assets

	Group and Society	
	2021 £m	2020 £m
Cost:		
At 1st January	35.4	25.7
Additions	5.7	9.7
Impairment	(1.0)	–
At 31st December	**40.1**	**35.4**
Amortisation:		
At 1st January	10.0	8.2
Charge for the year	4.1	1.8
At 31st December	**14.1**	**10.0**
Net book value:		
At 31st December	**26.0**	**25.4**

Computer software capitalised during the year relates to the group's transformation programme and associated technology investment. The total cost at 31st December 2021 includes £8.3m (2020: £3.6m) of assets in the course of construction which are not yet ready for use and therefore have no amortisation charged against them.

22. Property, plant and equipment

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 1st 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 31st December 2021	**8.4**	**8.4**	**59.1**	**58.0**	**43.1**	**43.1**	**110.6**	**109.5**
Depreciation:								
At 1st 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 31st December 2021	**3.0**	**3.0**	**37.8**	**37.3**	**33.2**	**33.2**	**74.0**	**73.5**
Net book value:								
At 31st December 2021	**5.4**	**5.4**	**21.3**	**20.7**	**9.9**	**9.9**	**36.6**	**36.0**
At 31st December 2020	6.1	6.1	19.0	18.4	11.4	11.4	36.5	35.9

FINANCIAL STATEMENTS

22. Property, plant and equipment (continued)

2020	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 1st January 2020	6.4	6.2	54.2	53.1	41.6	34.2	102.2	93.5
Additions	1.9	1.9	0.3	0.3	6.4	6.4	8.6	8.6
Disposals	(0.2)	–	–	–	(7.5)	(0.1)	(7.7)	(0.1)
At 31st December 2020	**8.1**	**8.1**	**54.5**	**53.4**	**40.5**	**40.5**	**103.1**	**102.0**
Depreciation:								
At 1st January 2020	1.1	1.0	33.8	33.3	32.4	25.0	67.3	59.3
Charge for the year	1.0	1.0	1.7	1.7	4.2	4.2	6.9	6.9
Impairment in the year	–	–	–	–	–	–	–	–
Disposals	(0.1)	–	–	–	(7.5)	(0.1)	(7.6)	(0.1)
At 31st December 2020	**2.0**	**2.0**	**35.5**	**35.0**	**29.1**	**29.1**	**66.6**	**66.1**
Net book value:								
At 31st December 2020	**6.1**	**6.1**	**19.0**	**18.4**	**11.4**	**11.4**	**36.5**	**35.9**
At 31st December 2019	5.3	5.2	20.4	19.8	9.2	9.2	34.9	34.2

Investment properties	Group and Society	
	2021 £m	2020 £m
Cost:		
At 1st January	13.2	13.3
Additions	0.2	–
Disposals	(0.5)	(0.1)
At 31st December	**12.9**	**13.2**
Depreciation:		
At 1st January	6.7	6.4
Charge for the year	0.4	0.3
Disposals	(0.4)	–
At 31st December	**6.7**	**6.7**
Net book value:		
At 31st December	**6.2**	**6.5**

Included within land and buildings additions is £4.9m (2020: £0.5m) 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. Both Principality House and the Friary offices were found to have valuations lower than their net book value. As the long term plan for the Friary is to let the office out, the market valuation can be considered the most approporiate estimate of the Friary's recoverable amount, therefore an impairment of £1.4m has been recognised against the Friary.

However, as Principality House is fundamental to the Society's long term operating plans, its value in use is a more appropriate estimate of its recoverable amount. Principality House's value in use has been measured at significantly higher than its market valuation, and therefore no impairment has been deemed necessary.

There were no impairments during 2020.

The fair value of investment properties as at 31st December 2021 is £11.5m (2020: £11.3m).

23. Shares

	Group and Society	
	2021 £m	2020 £m
Held by individuals	7,941.7	8,179.6
Other shares	3.2	3.6
Fair value adjustment for hedged risk	(1.1)	4.2
	7,943.8	**8,187.4**

24. Amounts owed to credit institutions

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Amounts owed to credit institutions	1,296.2	1,026.2	1,622.1	1,601.3

Included in the above amounts is £30.6m of collateral held under Credit Support Annex (CSA) agreements (2020: £8.5m).

25. Debt securities in issue

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Senior unsecured debt	298.4	307.0	298.4	307.0
Residential mortgage backed securities	397.6	665.6	–	–
	696.0	**972.6**	**298.4**	**307.0**

26. Other liabilities

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Other taxation and social security	1.2	1.0	1.2	1.0
Lease liabilities	5.7	6.1	5.7	6.1
Other creditors	4.4	10.0	4.4	10.0
	11.3	**17.1**	**11.3**	**17.1**

The undiscounted maturity profile of lease payments at 31st 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
5 years >	2.2	-	-	2.2
Total	**6.0**	**0.2**	**0.1**	**6.3**

The undiscounted maturity profile of lease payments at 31st December 2020 is shown below:

2020 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	0.8	-	-	0.8
Year 5	0.8	-	-	0.8
5 years >	2.6	-	-	2.6
Total	**6.7**	**0.2**	**0.1**	**7.0**

27. Deferred tax

The movement in net deferred tax is as follows:

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
At 1st January	0.7	0.6	0.6	0.7
Income statement charge	(2.5)	0.3	(2.4)	0.1
Statement of other comprehensive income charge	(1.3)	(0.2)	(1.3)	(0.2)
At 31st December	**(3.1)**	**0.7**	**(3.1)**	**0.6**

27. Deferred tax (continued)

Deferred tax assets and liabilities are attributable to the following items:

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Deferred tax assets:				
Accelerated tax depreciation	1.7	0.7	1.6	0.5
Other temporary differences	0.6	1.6	0.6	1.7
	2.3	**2.3**	**2.2**	**2.2**
Deferred tax liabilities:				
Other temporary differences	(5.4)	(1.7)	(5.3)	(1.5)
	(5.4)	**(1.7)**	**(5.3)**	**(1.5)**

The deferred tax (charge)/credit in the income statement comprises the following temporary differences:

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Accelerated tax depreciation	1.1	(0.2)	1.1	(0.1)
Fair value volatility on financial instruments in securitisation entities	(2.6)	0.2	(2.6)	0.2
Other movements	(1.0)	0.3	(1.0)	–
	(2.5)	**0.3**	**(2.5)**	**0.1**

The rate of corporation tax from 1st April 2022 will remain at 19%; however, the rate will increase to 25% from 1st 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 loss of £1.0m (2020: £1.1m gain) arising from the actuarial gain on retirement benefit obligations. The charge reflected in the income statement is not material.

28. Financial commitments and contingent liabilities

a) Other provisions for liabilities and charges

At 31st December 2021, the group holds a provision of £2.7m (2020: £2.8m), 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 £0.6m (2020: £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	
	2021 £m	2020 £m
Receivable within one year	0.7	0.8
Receivable between two and five years	3.2	3.4
Receivable after five years	5.1	5.6
	9.0	**9.8**

On 28th January 2011, a 25 year lease of floors one to four of Principality Buildings was granted to Travelodge Hotels Limited.

c) Capital commitments:

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Capital expenditure contracted for but not provided for	7.2	3.9	7.2	3.9

d) Loan commitments:

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
Loan commitments contracted but not paid	129.9	112.2	129.9	112.2

29. 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 31st 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**

29. Financial instruments (continued)

Categories of financial instruments (continued)

Society As at 31st 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 & 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 to 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	1,620.3	-	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	**10,150.5**	**-**	**23.8**	**10,174.2**
Total non-financial liabilities				28.2
General reserve and other reserves				521.7
Total Group reserves and liabilities				**10,724.1**

Group **As at 31st December 2020**	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	1,438.5	-	-	1,438.5
Loans and advances to credit institutions	290.7	-	-	290.7
Debt securities	-	78.7	-	78.7
Derivative financial instruments	-	-	23.7	23.7
Loans and advances to customers	9,204.9	-	-	9,204.9
Total financial assets	**10,934.1**	**78.7**	**23.7**	**11,036.5**
Total non-financial assets				84.4
Total group assets				**11,120.9**
Group liabilities:				
Shares	8,187.4	-	-	8,187.4
Amounts owed to credit institutions	1,024.4	-	1.9	1,026.2
Amounts owed to other customers	201.3	-	-	201.3
Debt securities in issue	965.6	-	7.0	972.6
Derivative financial instruments	-	-	106.2	106.2
Total financial liabilities	**10,378.7**	**-**	**115.0**	**10,493.7**
Total non-financial liabilities				32.6
General reserve and other reserves				594.6
Total Group reserves and liabilities				**11,120.9**

29. Financial instruments (continued)

Categories of financial instruments (continued)

Society **As at 31st December 2020**	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	1,438.5	-	-	1,438.5
Loans and advances to credit institutions	199.3	-	-	199.3
Debt securities	-	78.7	-	78.7
Derivative financial instruments	-	-	23.6	23.6
Loans and advances to customers	9,063.8	-	-	9,063.8
Loans and investments in subsidiaries	24.0	-	-	24.0
Total financial assets	**10,725.6**	**78.7**	**23.6**	**10,827.9**
Total non-financial assets				83.7
Total Society assets				**10,911.6**
Society liabilities:				
Shares	8,187.4	-	-	8,187.4
Amounts owed to credit institutions	1,599.4	-	1.9	1,601.3
Amounts owed to other customers	201.3	-	-	201.3
Debt securities in issue	300.0	-	7.0	307.0
Derivative financial instruments	-	-	97.2	97.2
Total financial liabilities	**10,288.1**	**-**	**106.1**	**10,394.2**
Total non-financial liabilities				29.4
General reserve and other reserves				488.0
Total Society reserves and liabilities				**10,911.6**

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	2021 Carrying value £m	2021 Fair value £m	2020 Carrying value £m	2020 Fair value £m
Group assets:					
Cash in hand and balances with Bank of England	i.	1,645.8	1,645.8	1,438.5	1,438.5
Loans and advances to credit institutions	ii.	165.8	173.2	290.7	298.2
Debt securities	iii.	76.3	76.3	78.7	78.7
Derivative financial instruments	iv.	52.8	52.8	23.7	23.7
Loans and advances to customers	v.	8,883.3	9,019.1	9,204.9	9,199.4
		10,824.0	**10,967.2**	**11,036.5**	**11,038.5**
Group liabilities:					
Shares	vii.	7,943.8	7,961.5	8,187.4	8,173.2
Amounts owed to credit institutions	viii.	1,296.2	1,296.2	1,026.2	1,026.2
Amounts owed to other customers	viii.	270.1	270.1	201.3	201.3
Debt securities in issue	ix.	696.0	702.3	972.6	984.9
Derivative financial instruments	iv.	24.7	24.7	106.2	106.2
		10,230.8	**10,254.8**	**10,493.7**	**10,491.8**

	Note	2021 Carrying value £m	2021 Fair value £m	2020 Carrying value £m	2020 Fair value £m
Society assets:					
Cash in hand and balances with Bank of England	i.	1,645.8	1,645.8	1,438.5	1,438.5
Loans and advances to credit institutions	ii.	93.7	93.7	199.3	199.3
Debt securities	iii.	76.3	76.3	78.7	78.7
Derivative financial instruments	iv.	50.1	50.1	23.6	23.6
Loans and advances to customers	v.	8,774.9	8,909.4	9,063.8	9,057.2
Loans and advances to subsidiaries	vi.	0.1	0.1	24.0	24.0
		10,640.9	**10,775.4**	**10,827.9**	**10,821.3**
Society liabilities:					
Shares	vii.	7,943.8	7,961.5	8,187.4	8,173.2
Amounts owed to credit institutions	viii.	1,622.1	1,622.2	1,601.3	1,601.3
Amounts owed to other customers	viii.	270.1	270.1	201.3	201.3
Debt securities in issue	ix.	298.4	303.8	307.0	317.5
Derivative financial instruments	iv.	23.8	23.8	97.2	97.2
Loans from subsidiaries	ix.	16.0	16.0	-	-
		10,174.2	**10,197.4**	**10,394.2**	**10,390.5**

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.

29. Financial instruments (continued)

Carrying and fair value (continued)

	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**

29. Financial instruments (continued)

	Group			
	2020 £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	23.7	-	14.6	9.0
Financial assets at fair value through other comprehensive income:				
Debt securities	78.7	78.7	-	-
Total	**102.3**	**78.7**	**14.6**	**9.0**
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	-	1.9	-
Debt securities in issue	7.0	7.0	-	-
Derivative financial instruments	106.2	-	97.2	9.0
Total	**115.0**	**7.0**	**99.1**	**9.0**

	Society			
	2020 £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	23.6	-	14.6	9.0
Financial assets at fair value through other comprehensive income:				
Debt securities	78.7	78.7	-	-
Total	**102.3**	**78.7**	**14.6**	**9.0**
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	-	1.9	-
Debt securities in issue	7.0	7.0	-	-
Derivative financial instruments	97.2	-	97.1	0.1
Total	**106.1**	**7.0**	**99.0**	**0.1**

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 2021 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.

30. Credit risk

The credit risk to which the group is exposed is described in the Risk Overview on pages 35 to 36. 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).

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	
	2021 £m	2020 £m	2021 £m	2020 £m
In respect of loans and advances to customers:				
Secured by a first charge on residential property	8,528.0	8,691.9	8,528.0	8,691.9
Secured by a first charge on land	285.1	307.3	285.1	307.3
Secured by a second charge on residential property	109.2	143.5	–	–
	8,922.3	9,142.7	8,813.1	8,999.2
Provision for impairment losses	(17.8)	(34.3)	(14.7)	(28.4)
Effective Interest Rate adjustments	13.5	17.3	11.2	13.8
Fair value adjustments	(34.7)	79.2	(34.7)	79.2
	8,883.3	**9,204.9**	**8,774.9**	**9,063.8**

FINANCIAL STATEMENTS

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	
	2021 £m	2020 £m	2021 £m	2020 £m
Retail financial services	8,033.3	8,175.7	8,033.3	8,175.7
Commercial lending	776.3	808.9	776.3	808.9
Secured personal lending	108.4	141.1	–	–
Fair value adjustments	(34.7)	79.2	(34.7)	79.2
	8,883.3	**9,204.9**	**8,774.9**	**9,063.8**

i) Retail financial services and secured personal lending credit 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	
	2021 %	2020 %	2021 %	2020 %
In Wales	33.7	33.5	30.3	30.7
Outside Wales	66.3	66.5	69.7	69.3
	100.0	**100.0**	**100.0**	**100.0**

The group holds a high quality buy-to-let portfolio with an amortised cost of £2,266.5m (2020: £2,269.2m). At the end of the year, 78% of buy-to-let mortgages were on interest only products, 21% were repayable by capital and interest repayments and 1% a combination of interest only and capital and interest.

Loan to value (LTV) is one of the main factors used to determine the credit quality of loans secured on residential property. The average index linked LTV in respect of the group's loans secured on residential property including mortgages under offer is estimated to be 55.7% (2020: 57.9%). Index-linked LTV banding is shown below:

	Group		Society	
	2021 %	2020 %	2021 %	2020 %
Less than 50%	38.0	36.1	38.1	35.5
More than 50% but less than 75%	45.2	42.2	45.1	42.7
More than 75% but less than 90%	13.6	16.2	13.6	16.3
More than 90%	3.2	5.5	3.2	5.5
	100.0	**100.0**	**100.0**	**100.0**

a) Loans and advances to customers (continued)

i) Retail financial services and secured personal lending credit risk (continued)

Performance

The percentage of retail lending cases fully secured by a first charge currently with arrears greater than three months is 0.50% (2020: 0.42%) which compares favourably with the industry average of 0.82% (UK Finance arrears and possession data at 30th September 2021). Residential lending cases fully secured by a first charge which were six months or more in arrears had arrears balances of £1.2m (31st December 2020: £1.0m) with 228 cases (31st December 2020: 195).

The percentage of secured personal loans currently in arrears of two months or more by number is 9.19% (2020: 8.35%), which by value is 11.10% (2020: 9.56%). These increases are due to a combination of an increase in the absolute value of arrears cases in 2021 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			
	2021		2020	
	£m	%	£m	%
Current	8,075.7	99.2	8,248.9	99.2
Past due up to 3 months	28.1	0.3	34.5	0.4
Past due 3 months up to 6 months	14.0	0.2	13.3	0.2
Past due 6 months up to 12 months	13.0	0.2	11.1	0.1
Past due over 12 months	9.7	0.1	8.9	0.1
Possessions	0.7	-	0.4	-
	8,141.2	**100.0**	**8,317.1**	**100.0**

	Society			
	2021		2020	
	£m	%	£m	%
Current	7,981.0	99.3	8,122.1	99.4
Past due up to 3 months	22.9	0.3	27.1	0.3
Past due 3 months up to 6 months	12.5	0.2	11.9	0.1
Past due 6 months up to 12 months	9.9	0.1	8.0	0.1
Past due over 12 months	6.3	0.1	5.8	0.1
Possessions	0.7	-	0.4	-
	8,033.3	**100.0**	**8,175.3**	**100.0**

30. Credit risk (continued)

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 £19,401.3m (2020: £19,233.3m).

The group holds collateral against loans and advances to residential customers in the form of mortgage interests over property. £0.6m (2020: £0.2m) 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:

	2021 £m	2020 £m
Retail financial services	8.3	12.6
Secured personal loans	3.1	5.9
	11.4	**18.5**

a) Loans and advances to customers (continued)

i) Retail financial services and secured personal lending credit risk (continued)

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. 10 properties were taken into possession during 2021 (2020: 2) with balances of £0.9m (2020: £0.2m).

The table below 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.

2021	Revised payment schedule £m	Transfer to interest-only £m	Term extensions £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**

2020	Revised payment schedule £m	Transfer to interest-only £m	Term extensions £m	Other £m	Total £m
Current	6.2	17.6	0.1	1.6	25.5
Past due up to 3 months	3.2	2.0	-	-	5.2
Past due 3 months up to 6 months	1.8	0.3	-	-	2.1
Past due 6 months up to 12 months	1.2	0.2	-	-	1.4
Past due over 12 months	0.4	-	-	-	0.4
	12.8	**20.1**	**0.1**	**1.6**	**34.6**

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 36.

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.

Risk concentrations

The group's commercial loan portfolio, excluding impairment provisions and fair value adjustments, comprises the following:

	Group and Society			
	2021		2020	
	£m	%	£m	%
Loans to Registered Social Landlords secured on residential property	164.1	20.9	180.2	21.8
Other loans secured on residential property	344.4	43.8	348.1	42.1
Loans secured on commercial property	277.5	35.3	299.1	36.1
	786.0	**100.0**	**827.4**	**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			
	2021		2020	
	£m	%	£m	%
Office	107.0	38.6	105.3	35.2
Retail	102.7	37.0	114.4	38.3
Industrial	51.9	18.7	58.9	19.7
Leisure	6.1	2.2	9.6	3.2
Land	0.6	0.2	1.0	0.3
Other	9.2	3.3	9.9	3.3
	277.5	**100.0**	**299.1**	**100.0**

30. Credit risk (continued)

a) Loans and advances to customers (continued)
ii) Commercial lending credit risk (continued)

Risk concentrations (continued)
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			
	2021		2020	
	£m	%	£m	%
Wales	368.5	46.9	385.4	46.7
Greater London	244.4	31.1	249.3	30.1
South East/East of England	53.7	6.8	51.1	6.2
Midlands	17.6	2.2	25.3	3.0
South West/South of England	56.4	7.2	53.2	6.4
North West/North of England	16.3	2.1	18.6	2.2
Mixed/other	29.1	3.7	44.5	5.4
	786.0	**100.0**	**827.4**	**100.0**

The average loan to value (LTV) in respect of the group's commercial loans is estimated to be 54.2% (2020: 54.8%). 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.

£18.4m of exposures have an LTV of greater than 100% (2020: £25.0m). Of these, £7.2m are already classified as impaired (2020: £11.6m).

The largest exposure to one counterparty is £26.3m (2020: £27.5m) or 3.3% (2020: 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 36.

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			
	2021		2020	
	£m	%	£m	%
Exposures not classified as higher risk	767.6	97.7	802.4	97.0
Watch-list	11.2	1.4	13.4	1.6
Impaired or past due up to 3 months	7.2	0.9	11.6	1.4
	786.0	**100.0**	**827.4**	**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	164.1	–	–	–	–	–	164.1	20.9
Commercial Investment (including Owner Occupier)	–	–	230.3	43.1	1.2	1.9	276.5	35.2
Residential Investment	–	10.8	258.7	18.3	3.5	3.0	294.3	37.4
Commercial Development	–	–	0.8	0.2	–	–	1.0	0.1
Residential Development	–	–	37.5	10.3	–	2.3	50.1	6.4
	164.1	**10.8**	**527.3**	**71.9**	**4.7**	**7.2**	**786.0**	**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.

The table below provides further information on commercial loans and advances by defaulted and delinquency status:

	Group and Society			
	2021		2020	
	£m	%	£m	%
Unimpaired				
Current	778.8	99.1	815.8	98.6
Past due 1 to 3 months	–	–	–	–
Impaired				
Past due 3 to 6 months	–	–	1.9	0.2
Past due 6 to 12 months	0.2	–	–	–
Past due over 12 months	–	–	–	–
Defaulted but not past due	4.8	0.6	9.7	1.2
Law of Property Act (LPA) Receivers appointed	2.2	0.3	–	–
	786.0	**100.0**	**827.4**	**100.0**

a) Loans and advances to customers (continued)
ii) Commercial lending credit risk (continued)

Performance (continued)

There is 1 commercial case (2020: 5) three months or more in arrears (fixed charge receiver appointed). Total arrears of one month or more are £0.2m (2020: £1.9m).

The total collateral held against commercial loans is estimated to be £1,615m (2020: £1,683m). 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:

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**

2020	Group and Society		
	Stage 1 £m	Stage 2 £m	Stage 3 £m
Commercial lending provisions	3.6	8.4	3.8
Total provisions	**3.6**	**8.4**	**3.8**

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 2021, 5 (2020: 20) accounts with balances totalling £4.7m (2020: £51.9m) in value were granted forbearance concessions. The total exposure in forbearance at December 2021 stands at balances of £31.1m and 14 accounts (2020: £54.3m, 23 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.

30. Credit risk (continued)

b) Treasury financial instruments

The treasury credit risk strategy is described in the Risk Overview on page 36.

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	
	2021 £m	2020 £m	2021 £m	2020 £m
UK Government securities	-	-	-	-
UK Supranational securities	50.3	50.9	50.3	50.9
UK Financial institutions	181.6	268.2	109.5	176.8
	231.9	**319.1**	**159.8**	**227.7**

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 £36.6m (2020: £8.5m) is held over derivative financial instruments.

The following table shows the exposures broken down by Fitch ratings:

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
AAA to AA-	128.0	161.9	128.0	161.9
A+ to A-	101.9	156.3	29.8	64.9
BBB+ to BBB-	2.0	0.9	2.0	0.9
	231.9	**319.1**	**159.8**	**227.7**

The geographical distribution of these exposures is as follows:

	Group		Society	
	2021 £m	2020 £m	2021 £m	2020 £m
UK	181.6	268.2	109.5	176.8
Multilateral development banks	50.3	50.9	50.3	50.9
	231.9	**319.1**	**159.8**	**227.7**

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.

31. Liquidity risk

The following tables analyse the gross contractual principal cash flows payable under financial liabilities.

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**

31. Liquidity risk (continued)

2020	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	-	4,659.9	1,482.6	2,040.7	-	8,183.2
Amounts owed to credit institutions	9.2	155.0	111.1	749.1	-	1,024.4
Other customers	-	161.4	39.9	-	-	201.3
Debt securities in issue	-	171.9	70.4	723.3	-	965.6
	9.2	**5,148.2**	**1,704.0**	**3,513.1**	**-**	**10,374.5**
Society:						
Non-derivative liabilities						
Shares	-	4,659.9	1,482.6	2,040.7	-	8,183.2
Amounts owed to credit institutions	8.5	307.1	169.8	1,114.0	-	1,599.4
Other customers	-	161.4	39.9	-	-	201.3
Debt securities in issue	-	-	0.8	299.2	-	300.0
	8.5	**5,128.4**	**1,693.1**	**3,453.9**	**-**	**10,283.9**
Group:						
Derivative liabilities						
Interest rate swaps	-	13.1	4.2	86.3	13.1	116.7
	-	**13.1**	**4.2**	**86.3**	**13.1**	**116.7**
Society:						
Derivative liabilities						
Interest rate swaps	-	1.3	4.2	78.6	13.1	97.2
	-	**1.3**	**4.2**	**78.6**	**13.1**	**97.2**

32. 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 31st December 2021, the Economic Value of the Group's balance sheet would have decreased by £9.5m in the case of a short rate down.

Currency risk

The group has no material exposure to foreign exchange rate fluctuations or changes in foreign currency interest rates.

33. 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 was an aggregate of £0.1m (2020: £0.1m) outstanding at the end of the financial year in respect of secured advances made prior to, or during the year, to Directors.

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 House, The Friary, 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 25th April 2022.

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 £0.1m (2020: £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 31st December 2021		
Nemo Personal Finance Limited	1.4	-
	1.4	**-**
Year ended 31st December 2020		
Nemo Personal Finance Limited	3.5	-
	3.5	**-**

At the year-end the following balances were outstanding:

	Loans owed to Society 2021 £m	Loans owed to Society 2020 £m
Nemo Personal Finance Limited	-	23.9
	-	**23.9**

	Surplus cash paid to Society 2021 £m	Surplus cash paid to Society 2020 £m
Nemo Personal Finance Limited	16.0	-
	16.0	**-**

Annual business statement

for the year ended 31st December 2021

1. Statutory percentages

	At 31st December 2021 %	At 31st December 2020 %	Statutory limit %
The lending limit	3.2	3.5	25.0
The funding limit	20.1	21.2	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

	2021 %	2020 %
As a percentage of shares and borrowings:		
Gross capital	6.3	6.1
Free capital	5.7	5.4
Liquid assets	18.5	17.4
As a percentage of mean total assets:		
Profit for the year as a percentage of statutory mean total assets	0.44	0.14
Management expenses as a percentage of statutory mean total assets	0.84	0.73

- 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 47 to 51.

Details of Directors' service contracts are included in the report of the Remuneration Committee on page 85.

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 actively consider Principality as a potential provider when approaching a new purchase.
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	Net zero means that we will reduce all of our scope 1 and 2 emissions to as little as possible by 2030 as well as the following elements of our scope 3 emissions: paper, water, external data centres, waste disposal, business travel, colleague commuting and home working. We will neutralise residual emissions with net zero aligned carbon removals. Scope 1 emissions - generated by directly owned or controlled sources i.e. fuel combustion and company-owned vehicles. Scope 2 emissions - purchased electricity. Scope 3 emissions - other indirect operational emissions that occur in the supply chain, both upstream and downstream.

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 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.

Glossary (continued)

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 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 1st 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.

Glossary (continued)

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.

ONLINE

principality.co.uk
@principalityBS

VISIT

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

To minimise the spread of COVID-19, local measures may be in place to protect both our staff and Members, please see branch display information.

CALL US

0330 333 4000•
(Open Mon–Fri 9am–5pm
Sat 9am–1pm)

Building your future

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

ARA 03/22-1

Principality
Building Society
Cymdeithas Adeiladu

Where home matters
principality.co.uk