HALF YEAR
FINANCIAL REPORT

2021

Building your future

Principality
Building Society
Cymdeithas Adeiladu

Where home matters
www.principality.co.uk

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Forward Looking Statements

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

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

Chief Executive's review

The first six months of 2021 continued to be a challenging period for us all as a result of the pandemic. As I look back over the first half of 2021, I am very proud of how our colleagues continued to provide award-winning service and the efforts of our branch network to stay open during the winter lockdown. Colleagues have maintained their focus and commitment to make Principality an attractive, safe place for savings and mortgages.

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. We also focused on the health and wellbeing of our colleagues by giving them the flexibility they needed to balance their personal needs with those of our business.

We improved our efforts to help first-time-buyers with attractive propositions in the first half of the year, helping almost 1,500 people to get on to the property ladder, despite a much more challenging housing market caused by pent up demand. Our capital and liquidity levels remain strong, well in excess of regulatory requirements and well able to withstand any challenging economic and market conditions.

It has been a very difficult period for the High Street but we remain committed to our branch and agency network, serving 70 communities across Wales and the Borders. Whilst our Members continue to value and visit our network, we will continue to support communities as we have done through lockdowns, by completing essential transactions and providing access to cash. This focus on our high street does not deflect us from our focus on developing technology to respond to the demand from Members and customers to interact over the phone, over video and digitally to enable them to manage their financial affairs.

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, how we ensure our Members and colleagues have a bigger say in how we run our business and how we continue to invest in the areas which we know positively impacts our communities.

Delivering value for Members

Our net retail mortgage lending was £24.7m in the first six months of this year (June 2020: £118.7m). Although retail lending is relatively flat, our mortgage applications remain strong in a housing market being supported by stamp duty reliefs which ended on 30 June 2021 in Wales. We expect net retail mortgage lending to remain relatively flat throughout 2021 as we embed our new mortgage platform and manage application volumes in the short term.

Balancing the needs of savers, whilst remaining competitive in the mortgage market is a constant focus and the savings rates we can offer to Members are directly impacted by the interest we earn on mortgages. However, we still delivered an average rate to savers of 0.77% compared to the market average of 0.32%[1] over the same period, maintaining our position as one of the best on the high street.

Our Commercial team have developed and delivered a £20m fund to support the development of low carbon housing in Wales. The Green Development Fund offers housing developers financial incentives for the delivery of low to zero carbon housing developments in Wales.

With the Welsh Government's ambition of reducing carbon emissions in Wales to net-zero by 2050 and with the Welsh housing sector accounting for a significant proportion of overall emissions, the commercial team have made it a priority to support housing developers who build greener properties. The team also work tirelessly to fund affordable housing schemes across Wales and hope to announce some further exciting green development funding before the end of this year.

[1] Source: CACI's CSDB, Stock. Weighted average interest rate comparison for fixed and variable rate products from January to April 2021.

Chief Executive's review (continued)

A resilient financial performance with an improving economic backdrop

As a mutual, Member-owned building society, our aim has never been to maximise profit but to focus on the long-term future of the Society. We have made a decision to be much more purpose driven so we can not only achieve our objective to help people get and stay in their homes for longer but also have a positive impact on improving the prosperity and resilience of customers, colleagues, clients and communities.

In 2020, we increased our provisions for potential future loan losses because of the great economic uncertainty caused by the pandemic. Over the last six months the economic outlook has improved and is much more promising for 2021 and beyond. The housing market is buoyant and employment is stable, although the impact of the tapering off of the furlough scheme has yet to materialise, which has reduced our overall level of provisioning. This reduction in provisions for losses on mortgages is largely responsible for our strong profit in the first six months of 2021, in the same way that increased provisions during the earlier stages of the pandemic last year resulted in lower levels of profitability in 2020. This has had a significant impact on our results for this interim period, resulting in an underlying profit before tax of £28.6m (six months to 30 June 2020: loss of £3.5m) and statutory profit before tax of £33.1m (six months to 30 June 2020: loss of £6.4m).

Transforming our business

During the first half of the year, 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 returning to the office in 2022. 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.

Members, Communities and Colleagues

I am very proud of the efforts our colleagues have made to improve the lives of others. As a purpose led business, we will continue to work hard to help our communities deal with the many challenges they face. In spring this year, we were delighted to announce that our colleagues and the business have helped to raise £1m for various charities we have supported during the past seven years.

We have continued in our efforts to educate young people and give them the financial skills to prepare them for adult life. In 2021, we have partnered with Young Money for their Fiver Challenge which encourages the development of entrepreneurial skills for children, while raising money for local causes. More than 3,200 children have already signed up for this digital challenge through their schools and we hope to see many more joining them by the end of the year. We also launched our Dylan Saving Squad financial education resource hub for teachers online, to help children learn about the importance of saving with fun and interactive games they can do with their families and at school.

It is exciting that we have developed a Member Pulse Panel, in which our Members tell us via online surveys and polls how they think the business is doing and what we are doing right, as well as honest feedback on where we can make improvements. More than 1,500 Members contribute regularly and we encourage more to participate so we can do a better job of meeting Members' and customer needs.

Chief Executive's review (continued)

Members, Communities and Colleagues (continued)

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 and beyond, 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 culture at Principality is renowned for being one that is friendly, open and inclusive and we actively encourage colleagues to be themselves at work. Our colleagues are passionate about doing the right thing for our Members and supporting our local communities. As key workers, our branch colleagues were committed to supporting our Members in the best way and providing an essential service throughout the pandemic. This is reflected in our Net Promoter Score, with 80.8 of Members saying they would recommend us to family or friends based on their level of satisfaction with Principality (December 2020: 79.8).

One of our priorities is to build an inclusive, inspiring workplace where everyone can be their authentic self and where the diversity of our communities is reflected within our teams. We know that we can always do better as an organisation and we have a dedicated Diversity and Inclusion Lead who is working with our Board and Senior Leadership team on our strategy and action plan.

Outlook

The economic environment looks to be more optimistic going forward compared to the previous 18 months, 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. We recognise that expectations of us are changing. We will continue to adapt, invest and improve so that we remain relevant for the long term and ready to face future challenges.

Thank you for your continued support.

Julie-Ann Haines
Chief Executive Officer
4 August 2021

Business review
for the six months ended 30 June 2021

Key Performance Indicators

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

	Six months to 30 June 2021	Six months to 30 June 2020	Year ended 31 December 2020
Purpose Led Organisation			
Net Retail Mortgage Growth	£24.7m	£118.7m	£182.2m
Net Retail Savings Growth	£(21.2)m	£0.8m	£596.1m
Brand Consideration	28.0%	18.5%	17.6%
Cost Income Ratio[1]	69.0%	78.8%	71.8%
Stand-Out Experience			
Net Promoter Score[2]	80.8	81.2	79.8
Profit/(Loss) Before Tax	£33.1m	£(6.4)m	£19.9m
Underlying Profit/(Loss) Before Tax	£28.6m	£(3.5)m	£24.1m
Net Interest Margin	1.14%	0.99%	1.00%
Common Equity Tier 1 Ratio[3]	30.70%	24.48%	27.10%

[1] The cost income ratio measures management expenses (administration expenses, depreciation and amortisation) as a proportion of total income.

[2] Source: Internal survey data for the six months ended 30 June 2021.

[3] Excluding unaudited interim profits/losses. The equivalent ratio including unaudited interim profits at 30 June 2021 would be 32.06%.

The above key performance indicators, apart from profit/loss before tax, are alternative performance measures (APMs) which are used internally to inform key management decisions. Further information on these APMs can be found within the 2020 Annual Report and Accounts within the strategic report and glossary sections.

Financial performance

Income statement

As detailed in the Chief Executive's review, the underlying profit before tax for the six months to 30 June 2021 was £28.6m (30 June 2020: £3.5m loss). Statutory profit before tax was £33.1m (30 June 2020: £6.4m loss). Both have been impacted by a £9.1m release (30 June 2020: £17.7m charge) in provision for loan losses in the first six months of this year due to rising house prices and more optimistic macroeconomic forecasts, whereas in 2020 there was a significant charge due to the uncertainty of the economic impacts of the coronavirus pandemic. The table below details the adjustments made to statutory profit/(loss) to arrive at underlying profit/(loss):

	30 June 2021 £m	30 June 2020 £m	31 December 2020 £m
Profit/(loss) before tax	**33.1**	**(6.4)**	**19.9**
Adjusted for:			
Fair value (gains)/losses	(4.5)	2.9	4.1
Additional pension charge for GMP equalisation[1]	-	-	0.1
Underlying profit/(loss) before tax	28.6	(3.5)	24.1

[1] Guaranteed Minimum Pension (GMP).

The purpose of the underlying measure is to reflect management's view of the group's underlying performance, presented to aid comparability across reporting periods by adjusting for items which affect statutory measures but are deemed to be either non-recurring or fair value movements which are predominantly driven by swap prices that are outside of managements control. This aligns to measures used by management to monitor the performance of the business.

Business review (continued)
for the six months ended 30 June 2021

Net interest margin

Net interest margin for the period was 1.14% (30 June 2020: 0.99%). This increase was primarily due to a reduction in funding costs, driven by a shift in retail savings market pricing, together with utilisation of the Bank of England's Term Funding Scheme (TFSME) to refinance planned wholesale maturities. In response to lower funding costs, retail mortgage pricing has also fallen over the period, which together with the continued planned reduction in the loan assets held in the secured personal lending portfolio to £124.3m (31 December 2020: £141.2m) has resulted in an £8.2m reduction in interest receivable and an £18.4m reduction in interest payable.

Fair value movements

Fair value movements represent the change in value of certain assets and liabilities to reflect underlying market rates. These movements are primarily timing differences, which will reverse as the asset or liability approaches maturity. During the period, the group recognised a gain of £4.5m in the income statement (30 June 2020: £2.9m loss) in relation to these movements in fair value.

Operating expenses

Operating expenses increased when compared with the same period last year at £44.0m (30 June 2020: £39.6m). These were expected to increase following investment in our change delivery operating model and amortisation from intangible assets generated by the investment in our core mortgages and savings platforms. The reduction in the cost income ratio is due primarily to an increase in net interest income. Focus on managing the core cost base of the business as a proportion of assets remains a priority. The management expense ratio has increased marginally at the half year due to the slightly higher cost base and a lower level of assets.

Total operating expenses are set out in the table below:

	30 June 2021 £m	30 June 2020 £m	31 December 2020 £m
Retail financial services	42.4	38.0	77.1
Commercial lending	1.3	1.2	2.5
Secured personal lending	0.3	0.4	0.3
Total operating expenses	44.0	39.6	79.9
Management expense ratio[1]	0.81%	0.75%	0.73%
Cost income ratio	69.0%	78.8%	71.8%

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

Impairment provisions for losses on loans and advances

The impairment provision movement over the first half of the year was a release of £9.1m to £25.0m (30 June 2020: charge of £17.7m to £43.3m). The performance of the group's loan portfolios continues to be strong with low arrears levels, rising house prices and more optimistic macroeconomic forecasts driving provision releases in 2021.

The group takes a conservative approach to lending and has robust affordability, credit quality and underwriting standards. The release for the first half of 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. This view will be revised at each financial reporting date based on the latest expectations at that time.

Business review (continued)
for the six months ended 30 June 2021

Impairment provisions for losses on loans and advances (continued)

Total impairment provisions held are as follows:

	30 June 2021 £m	30 June 2020 £m	31 December 2020 £m
Retail mortgages	8.9	21.9	12.6
Secured personal lending	4.4	10.4	5.9
Commercial lending	11.7	11.0	15.8
Total	25.0	43.3	34.3

Statement of financial position

Total assets have reduced to £10,926.4m (31 December 2020: £11,120.9m). A reduction was anticipated, as wholesale funds raised through the TFSME at the start of 2021 were used to repay more expensive forms of funding held, including the redemption of the group's residential mortgage backed issuance (RMBS) which was repaid in the period. In addition, the Commercial Lending book reduced to £764.2m (31 December 2020: £809m), mainly due to expected repayments within the period.

Loans and advances to customers

The retail mortgage portfolio increased to £8,200.4m (31 December 2020: £8,175.7m), and the quality of the loans remains strong with an average balance to value of 55.0% (31 December 2020: 57.9%). The Commercial lending portfolio reduced to £764.2m (31 December 2020: £808.9m), and the secured personal lending portfolio continued to run off, decreasing to £124.3m (31 December 2020: £141.2m).

Funding

Funding levels are closely monitored to maintain a diverse and balanced funding base. The majority of funding comes from retail savings, which has seen a small reduction at £8,163.9m (31 December 2020: £8,187.4m) as growth in mortgages has remained flat during in the first half of the year.

Capital and liquidity

The group's Common Equity Tier 1 ratio, which measures qualifying capital reserves as a proportion of risk weighted assets, increased to 30.70% in the period (31 December 2020: 27.10%). This increase has largely been driven by a relative decrease in the level of risk attributed to certain loan assets as a result of increasing house prices. The leverage ratio, which measures Tier 1 capital as a proportion of total on and off balance sheet assets, increased to 5.42% (31 December 2020: 5.15%).

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

Business review (continued)
for the six months ended 30 June 2021

Capital and liquidity (continued)

The business continues to hold a conservative buffer of high quality liquid assets, with a liquidity ratio of 16.6% (31 December 2020: 17.4%). The Liquidity Coverage Ratio (LCR) is 242.3% at 30 June 2021 (31 December 2020: 206.8%), which remains well above the current regulatory minimum of 100%.

Principal risks and uncertainties

The principal risks and uncertainties affecting the group were set out in the Risk Overview section of the Strategic Report in the Annual Report and Accounts for the year ended 31 December 2020. These risks are categorised as: credit, market, liquidity and funding, conduct, operational, business, solvency and legal and regulatory risk, and are common to most financial services firms in the UK.

These remain the principal risks to the group at 30 June 2021.

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

Tom Denman
Chief Financial Officer
4 August 2021

Condensed consolidated income statement
Group interim results for six months to 30 June 2021

	Notes	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Interest receivable and similar income	3	99.0	107.2	205.6
Interest payable and similar charges	4	(36.7)	(55.1)	(97.0)
Net interest income		62.3	52.1	108.6
Fees and commission receivable	5	2.1	1.9	4.1
Fees and commission payable		(0.9)	(1.0)	(2.1)
Net fee and commission income		1.2	0.9	2.0
Other operating income		0.3	0.3	0.7
Other fair value gains/(losses)	6	4.5	(2.9)	(4.1)
Net operating income		68.3	50.4	107.2
Administrative expenses	7	(38.5)	(35.6)	(70.9)
Depreciation and amortisation		(5.5)	(4.0)	(9.0)
Operating expenses		(44.0)	(39.6)	(79.9)
Impairment credit/(charge) for losses on loans and advances	14	9.1	(17.9)	(9.1)
Provisions for liabilities and charges	11	(0.3)	0.7	1.7
Operating profit/(loss) and profit/(loss) before taxation		33.1	(6.4)	19.9
Taxation (expense)/credit	9	(7.2)	1.2	(4.0)
Profit/(loss) for the period/year		25.9	(5.2)	15.9

Condensed consolidated statement of other comprehensive income
Group interim results for six months to 30 June 2021

	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Profit/(loss) for the period/year	25.9	(5.2)	15.9
Items that will not be reclassified subsequently to profit and loss:			
Actuarial gain/(loss) on retirement benefit obligations	1.0	(0.4)	(5.7)
Tax on retirement benefit obligations	-	0.2	1.1
Items that may be reclassified subsequently to profit and loss:			
Loss on assets at fair value through other comprehensive income	(0.1)	(0.1)	(0.1)
Tax on assets at fair value through other comprehensive income	-	-	-
Total comprehensive income/(expense) for the period/year	26.8	(5.5)	11.2

Condensed consolidated statement of financial position
Group interim results as at 30 June 2021

	Notes	30 June 2021 £m (Unaudited)	30 June 2020 £m (Unaudited)	31 December 2020 £m (Audited)
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		1,409.9	797.8	1,438.5
Loans and advances to credit institutions		209.4	291.8	290.7
Debt securities		79.8	115.5	78.7
		1,699.1	1,205.1	1,807.9
Derivative financial instruments		26.1	27.9	23.7
Loans and advances to customers:				
Loans fully secured on residential property		8,833.9	8,881.1	8,897.7
Other loans		287.3	316.6	307.3
	10	9,121.2	9,197.7	9,204.9
Intangible fixed assets		26.4	23.0	25.4
Property, plant and equipment		36.5	37.6	36.5
Investment properties		6.6	6.7	6.5
Current tax assets		-	1.5	-
Deferred tax assets		1.3	3.3	2.3
Other assets		0.5	4.0	4.4
Retirement benefit obligations	8	-	1.0	-
Prepayments and accrued income		8.7	7.8	9.3
Total assets		10,926.4	10,515.6	11,120.9
Liabilities				
Shares		8,163.9	7,594.7	8,187.4
Deposits and debt securities:				
Amounts owed to credit institutions		1,069.0	1,055.6	1,026.2
Amounts owed to other customers		228.8	102.7	201.3
Debt securities in issue		755.2	1,041.1	972.6
		2,053.0	2,199.4	2,200.1
Derivative financial instruments		60.0	116.7	106.2
Current tax liabilities		1.0	-	1.1
Other liabilities		13.5	14.1	17.1
Provisions for liabilities	11	3.1	3.7	2.8
Accruals and deferred income		8.0	8.3	7.2
Deferred tax liabilities		2.6	0.8	1.7
Retirement benefit obligations	8	-	-	2.7
Total liabilities		10,305.1	9,937.7	10,526.3
General reserve		620.2	576.7	593.4
Other reserves		1.1	1.2	1.2
Total equity and liabilities		10,926.4	10,515.6	11,120.9

Condensed consolidated statement of changes in Members' interests
Group interim results for six months to 30 June 2021

	Six months to 30 June 2021 (Unaudited)		
	General Reserve £m	Fair Value through OCI reserve £m	Total equity attributable to Members £m
Balance at 1 January 2021	593.4	1.2	594.6
Comprehensive income/(expense) for the period	26.8	(0.1)	26.7
At 30 June 2021	620.2	1.1	621.3

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

All items dealt with in arriving at the profit for the period, and the preceding financial periods, relate to continuing operations. The accounting policies and notes on pages 13 to 26 form part of these accounts.

Condensed consolidated statement of cash flows
Group interim results for six months to 30 June 2021

	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Net cash flows from operating activities	117.8	(210.9)	443.8
Cash flows from investing activities			
Purchase of intangible assets	-	(6.1)	(9.7)
Purchase of property, plant and equipment	(6.6)	(5.1)	(6.5)
Purchase of investment securities	(9.0)	(43.8)	(53.4)
Proceeds from sale and maturity of investment securities	7.8	93.4	139.9
Net cash flows from investing activities	**(7.8)**	**38.4**	**70.2**
Cash flows from financing activities			
Interest paid on subscribed capital	-	(1.7)	(1.7)
Interest paid on debt securities in issue	(5.5)	(8.9)	(15.7)
Proceeds from issuance of debt securities in issue	-	1.8	28.9
Redemption of debt securities in issue	(213.8)	(72.9)	(139.7)
Repayments of lease liabilities	(0.6)	(0.7)	(1.2)
Repayment of subscribed capital	-	(60.0)	(60.0)
Net cash flows from financing activities	**(219.9)**	**(142.4)**	**(189.4)**
(Decrease)/increase in cash and cash equivalents	(109.9)	(314.9)	324.7
Cash and cash equivalents at beginning of period/year	1,729.2	1,404.5	1,404.5
Cash and cash equivalents at end of period/year	**1,619.3**	**1,089.6**	**1,729.2**
Represented by:			
Cash and balances with the Bank of England	1,409.9	797.8	1,438.5
Loans and advances to credit institutions repayable on demand	209.4	291.8	290.7
	1,619.3	1,089.6	1,729.2
Operating activities			
Profit/(loss) before taxation	33.1	(6.4)	19.9
Adjusted for:			
Depreciation and amortisation	5.7	4.0	9.0
Charge on defined benefit pension scheme	-	-	0.1
Impairment on loans and advances to customers	(9.1)	17.9	9.1
Change in fair values	40.8	(54.2)	(40.0)
Charge to/(release) of other provisions	0.4	-	(1.7)
Interest on debt securities in issue	5.2	8.3	14.6
Interest on subscribed capital	-	1.7	1.7
Non-cash items included in profit before tax	0.4	0.2	0.8
Changes in net operating assets			
Loans and advances to customers	46.1	(119.3)	(134.1)
Other operating assets	3.5	(0.7)	(3.0)
Derivative financial instruments	(48.6)	59.7	53.4
Shares	(21.2)	0.8	596.1
Deposits	70.3	(112.1)	(71.8)
Other operating liabilities	(2.6)	(4.3)	(2.5)
Contributions paid into defined benefit scheme	(1.7)	(1.5)	(3.1)
Taxation paid	(4.5)	(5.0)	(4.7)
Net cash flows from operating activities	**117.8**	**(210.9)**	**443.8**

Notes to the accounts
for the six months ended 30 June 2021

1. Basis of preparation

The condensed consolidated set of financial statements of the group for the half-year ended 30 June 2021 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with International Accounting Standard (IAS) 34 Interim Financial Reporting, as adopted by the European Union. The annual financial statements of the group are prepared in accordance with IFRSs as adopted by the European Union. The accounting policies adopted are consistent with those of the previous financial year.

Going concern

The Directors have assessed the viability of the group, taking into account business strategy, principal risks, current economic conditions and the financial and continued operational impact on the group from the COVID-19 pandemic. The approach taken is consistent with that undertaken at the 2020 year-end.

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

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

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

New and amended standards adopted by the group

There were no new standards adopted in the current year.

Notes to the accounts
for the six months ended 30 June 2021

1. Basis of preparation (continued)

Impact of standards issued but not yet applied

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

Judgements in applying accounting policies and critical accounting estimates

There are no significant judgements made in applying the group's accounting policies. The areas of critical accounting estimates remain consistent with those disclosed in the 2020 Annual Report and Accounts, being impairment provisions on loans and advances (note 14), retirement benefit obligations (note 8) and provisions for customer and regulatory complaints (note 11).

2. Business segments

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

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

	Six months to 30 June 2021 (Unaudited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	51.4	7.2	3.7	62.3
Other income and charges	5.2	0.8	-	6.0
Net operating income	56.6	8.0	3.7	68.3
Operating expenses	(42.4)	(1.3)	(0.3)	(44.0)
Impairment provision for losses on loans and advances	3.9	4.1	1.1	9.1
Provision for other liabilities and charges	-	-	(0.3)	(0.3)
Operating profit and profit before taxation	18.1	10.8	4.2	33.1
Taxation expense				(7.2)
Profit after taxation				25.9

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

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

2. Business segments (continued)

	Year ended 31 December 2020 (Audited)			
	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 and charges	(3.0)	1.6	-	(1.4)
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 and 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

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

	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Total assets by business segments			
Retail financial services	10,029.7	9,495.1	10,141.0
Secured personal lending	124.3	156.9	141.2
Commercial lending	772.4	863.6	838.7
Total assets	10,926.4	10,515.6	11,120.9
Total liabilities and equity by business segment			
Retail financial services and Commercial lending	10,802.1	10,358.7	10,979.7
Secured personal lending	124.3	156.9	141.2
Total liabilities and equity	10,926.4	10,515.6	11,120.9

3. Interest receivable and similar income

	Group		
	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
On loans fully secured on residential property	106.9	112.8	219.2
On other loans	5.0	4.0	11.5
On debt securities	0.4	0.7	1.1
On other liquid assets	0.6	2.4	2.9
On derivative financial instruments	(13.9)	(12.7)	(29.1)
	99.0	107.2	205.6

Notes to the accounts
for the six months ended 30 June 2021

4. Interest payable and similar charges

	Group		
	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
On shares held by individuals	31.3	45.3	81.8
On deposits and debt securities	7.5	12.3	21.0
On subscribed capital	-	1.7	1.7
On lease liabilities	0.2	0.1	0.2
On derivative financial instruments	(2.3)	(4.3)	(7.7)
	36.7	55.1	97.0

5. Fees and commission receivable

	Group		
	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Insurance and related financial service products	0.5	0.6	1.1
Mortgage related fees	1.6	1.3	3.0
	2.1	1.9	4.1

6. Other fair value gains and losses

	Group		
	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Gains/(losses) on derivatives in hedging relationships	44.0	(53.3)	(41.3)
Gains/(losses) on derivatives not in hedging relationships	1.1	(2.2)	(2.8)
Gains/(losses) on derivatives	45.1	(55.5)	(44.1)
Gains on economic hedged items	3.2	5.0	7.2
(Losses)/gains on hedged items attributable to hedged risk	(43.8)	47.6	32.8
(Losses)/gains on hedged items	(40.6)	52.6	40.0
	4.5	(2.9)	(4.1)

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.

Notes to the accounts
for the six months ended 30 June 2021

7. Administrative expenses

	Group		
	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Wages and salaries	20.3	18.3	35.8
Social security costs	1.8	2.0	3.8
Other pension costs	1.3	1.1	2.4
	23.4	21.4	42.0
Other administrative expenses	15.1	14.2	28.9
	38.5	35.6	70.9

8. Retirement benefit obligations

	Group		
	30 June 2021 £m (Unaudited)	30 June 2020 £m (Unaudited)	31 December 2020 £m (Audited)
Fair value of plan assets	82.0	79.9	82.7
Present value of funded and unfunded obligations	(82.0)	(78.9)	(85.4)
Pension scheme surplus/(deficit)	-	1.0	(2.7)

The pension scheme has moved from a £2.7m deficit at December 2020 to a reduced deficit position of £21k, as a result of contributions of £1.7m paid by the Society and a fair value gain of £1.0m during the period.

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

	Group	
	Increase 0.5% £m	Decrease 0.5% £m
Discount rate	(6.8)	6.8
Inflation	6.7	(6.7)
Life expectancy (+1 year/ -1 year)	3.3	(3.3)

Notes to the accounts
for the six months ended 30 June 2021

9. Taxation

Taxation for the group for the 6 months to 30 June 2021 is charged at 21.8% (30 June 2020: 18.8%), representing the best estimate of the annual effective tax rate expected for the full year, applied to the forecast pre-tax income for the year and pro-rated for the six-month period. The effective statutory rate of corporation tax for the year ending December 2020 was 20.10%. The June 2020 and December 2020 tax charges/(credits) did not include the banking surcharge due to annual and estimated annual profits being below £25.0m

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

	Group		
	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Profit/(loss) before tax	33.1	(6.4)	19.9
Profit/(loss) multiplied by the standard rate of corporation tax at 19.00% (2020: 19.00%)	6.3	(1.2)	3.7
Effects of:			
Expenses not deductible for tax purposes	0.1	(0.1)	-
Adjustments to prior years	-	0.1	0.3
Impact of banking surcharge	0.6	-	-
Timing differences	0.2	-	-
Tax charge/(credit)	7.2	(1.2)	4.0

10. Loans and advances to customers

	Group		
	30 June 2021 £m (Unaudited)	30 June 2020 £m (Unaudited)	31 December 2020 £m (Audited)
Fully secured on residential property	8,810.5	8,810.3	8,835.4
Fully secured on land	287.3	316.6	307.3
	9,097.8	9,126.9	9,142.7
Provision for impairment losses	(25.0)	(43.3)	(34.3)
Unamortised loan origination fees	15.9	18.6	17.3
Fair value adjustment for hedged risk	32.5	95.5	79.2
	9,121.2	9,197.7	9,204.9

11. Provisions for liabilities

	Group		
	30 June 2021 £m (Unaudited)	30 June 2020 £m (Unaudited)	31 December 2020 £m (Audited)
At beginning of the period/year	2.8	4.4	4.4
Charge for the period/year	0.3	-	0.1
Release during the period/year	-	(0.7)	(1.7)
At end of the period/year	3.1	3.7	2.8

11. Provisions for liabilities (continued)

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

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

12. Related party transactions

The group had no related party transactions outside the normal course of the business during the six months to 30 June 2021. Transactions for this period are similar to those for the year to 31 December 2020, details of which can be found in note 34 of the 2020 Annual Report and Accounts.

13. Financial instruments

Carrying values and fair values

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

	30 June 2021		31 December 2020	
	Carrying Value £m (Unaudited)	Fair Value £m (Unaudited)	Carrying Value £m (Audited)	Fair Value £m (Audited)
Total assets				
Cash in hand and balances with Bank of England	1,409.9	1,409.9	1,438.5	1,438.5
Loans and advances to credit institutions	209.4	216.9	290.7	298.2
Debt securities	79.8	79.8	78.7	78.7
Derivative financial instruments	26.1	26.1	23.7	23.7
Loans and advances to customers	9,121.2	9,173.2	9,204.9	9,199.4
	10,846.4	10,905.9	11,036.5	11,038.5
Total liabilities				
Shares	8,163.9	8,161.6	8,187.4	8,173.2
Amounts owed to credit institutions	1,069.0	1,069.0	1,026.2	1,026.2
Amounts owed to other customers	228.8	228.8	201.3	201.3
Debt securities in issue	755.2	767.3	972.6	984.9
Derivative financial instruments	60.0	60.0	106.2	106.2
	10,276.9	10,286.7	10,493.7	10,491.8

Further details on the methods and assumptions which have been applied in determining fair value are set out in note 30 of the 2020 Annual Report and Accounts.

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13. Financial instruments (continued)

Assets and liabilities measured at fair value

	30 June 2021 (Unaudited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	26.1	-	21.8	4.3
Financial assets at fair value through other comprehensive income:				
Debt securities	79.8	79.8	-	-
Total	105.9	79.8	21.8	4.3
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	-	1.9	-
Debt securities in issue	3.4	3.4	-	-
Derivative financial instruments	60.0	-	55.7	4.3
Total	65.3	3.4	57.6	4.3

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

	31 December 2020 (Audited)			
	£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	102.4	78.7	14.6	9.0
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.8	-	1.8	-
Debt securities in issue	7.0	7.0	-	-
Derivative financial instruments	106.2	-	97.2	9.0
Total	115.0	7.0	99.0	9.0

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

Notes to the accounts
for the six months ended 30 June 2021

13. Financial instruments (continued)

Hierarchy for fair value disclosures

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

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

14. Credit risk

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

i) Loans and advances to customers

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

	Group		
	30 June 2021 £m (Unaudited)	30 June 2020 £m (Unaudited)	31 December 2020 £m (Audited)
In respect of loans and advances to customers:			
Secured by a first charge on residential property	8,684.8	8,649.0	8,691.9
Secured by a first charge on land	287.3	316.6	307.3
Secured by a second charge on residential property	125.7	161.3	143.5
	9,097.8	9,126.9	9,142.7
Provisions for impairment losses	(25.0)	(43.3)	(34.3)
Effective interest rate adjustments	15.9	18.6	17.3
Fair value adjustments	32.5	95.5	79.2
	9,121.2	9,197.7	9,204.9

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

	Retail Financial Services		Commercial Lending		Secured Personal Lending	
Stage	30 June 2021 £m (Unaudited)	31 December 2020 £m (Audited)	30 June 2021 £m (Unaudited)	31 December 2020 £m (Audited)	30 June 2021 £m (Unaudited)	31 December 2020 £m (Audited)
1	7,290.6	7,385.5	781.0	817.3	68.2	87.6
2	1,122.8	1,103.2	91.9	94.1	41.1	39.7
3	44.0	44.6	11.9	11.7	14.9	15.1
	8,457.5	8,533.4	884.8	923.0	124.2	142.4

14. Credit risk (continued)

The observed improvements in HPI, together with improvements in both HPI forecasts and, to a lesser extent, arrears rates have significantly reduced provisions. However, with the vast majority of stage 2 classification being due to PD migration, the aforementioned three factors have not driven in a reduction in stage 2 exposure in Retail and Nemo, as shown in the below above.

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

	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
Retail financial services	8.9	21.9	12.6
Secured personal lending	4.4	10.4	5.9
Commercial lending	11.7	11.0	15.8
	25.0	43.3	34.3

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

Retail Financial Services and Secured Personal Lending

Stage	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
1	85.7%	92.0%	86.1%
2	13.6%	7.4%	13.2%
3	0.7%	0.6%	0.7%
	100.0%	100.0%	100.0%

Commercial Lending

Stage	6 months to 30 June 2021 £m (Unaudited)	6 months to 30 June 2020 £m (Unaudited)	Year ended 31 December 2020 £m (Audited)
1	88.2%	88.7%	88.5%
2	10.5%	10.3%	10.2%
3	1.3%	1.0%	1.3%
	100.0%	100.0%	100.0%

The average index-linked loan balance to value (BTV), in respect of the group's loans secured by a first or second charge on residential property, is 55.0% (31 December 2020: 57.9%).

The percentage of retail lending cases fully secured by a first charge, currently with arrears greater than three months, is 0.44% (31 December 2020: 0.42%).

Residential lending cases fully secured by a first charge which were six months or more in arrears had arrears balances of £1.2m (31 December 2020: £1.0m) with 221 (31 December 2020: 195) cases.

14. Credit risk (continued)

The percentage of secured personal loans currently in arrears by two months or more by number is 8.94% (31 December 2020: 8.35%), which by value is 10.50% (31 December 2020: 9.56%).

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

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

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

Stage	Retail financial services £m	Secured personal lending £m	Commercial lending £m
Stage 1 to Stage 2	0.7	0.2	0.2
Stage 2 to Stage 1	(0.5)	(0.1)	(0.1)

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

Retail financial services £m	Secured personal lending £m	Commercial lending £m
1.8	0.9	2.3

Forward looking economic scenarios

Forecasts of economic variables together with probability weightings are supplied by an external provider. Economic scenarios have been selected which take account of a range of possible economic outcomes. As shown in the table below there has been a significant improvement within the severe downside scenario provided by our external providers between December 2020 and June 2021, particularly in relation to HPI. Whilst the success of the vaccination programme and the easing of lockdown measures has improved the outlook in respect of base and upside scenarios, management feel a more severe downside risk remains. In order to address this concern management have consolidated the downside weightings into the severe downside scenario which has seen the weighting increased from 14.5% to 37.5%. Management consider this adjustmentment sufficient to address the non-linear impact of a lower probability but more severe downside.

Scenario	Weighting at 30 June 2021 %	2021 Scenario				Weighting at 31 Dec 2020 %	2020 Scenario			
		2021 %	2022 %	2023 %	2024 %		2021 %	2022 %	2023 %	2024 %
HPI										
Base	32.5	(1.4)	3.2	6.3	5.2	32.5	(8.1)	2.3	6.9	5.3
Upside	30.0	3.8	10.2	6.9	3.9	30.0	(1.6)	7.5	6.7	4.5
Downside	-	-	-	-	-	23.0	(12.5)	3.0	8.9	7.1
Severe Downside	37.5	(7.1)	(6.8)	2.8	5.8	14.5	(20.2)	(3.9)	(6.1)	7.5

14. Credit risk (continued)

Scenario	Weighting at 30 June 2021 %	2021 Scenario 2021 %	2022 %	2023 %	2024 %	Weighting at 31 Dec 2020 %	2020 Scenario 2021 %	2022 %	2023 %	2024 %
Unemployment										
Base	32.5	6.7	6.0	5.3	5.0	32.5	7.8	6.8	6.0	5.5
Upside	30.0	6.3	4.9	4.3	4.2	30.0	6.8	5.7	5.1	4.8
Downside	-	-	-	-	-	23.0	8.8	8.0	7.0	6.3
Severe Downside	37.5	7.5	9.1	8.2	7.8	14.5	10.5	10.2	8.9	8.1

Scenario	Weighting at 30 June 2021 %	2021 Scenario 2021 %	2022 %	2023 %	2024 %	Weighting at 31 Dec 2020 %	2020 Scenario 2021 %	2022 %	2023 %	2024 %
GDP										
Base	32.5	9.4	7.0	5.1	2.8	32.5	8.8	8.0	5.1	2.8
Upside	30.0	12.7	7.2	5.4	3.7	30.0	13.0	7.3	5.9	3.7
Downside	-	-	-	-	-	23.0	4.7	8.3	5.1	3.1
Severe Downside	37.5	2.9	2.8	4.4	3.0	14.5	(0.1)	6.4	3.8	2.3

In determining ECLs at 30 June 2021, we have taken the decision to treat those loans still under COVID-19 related payment deferrals as having experienced a significant increase in credit risk. This includes 100 (31 December 2020: 847) loans within the retail portfolio and 12 (31 December 2020: 130) in the secured personal lending portfolio. A number of interventions have been made during the pandemic, including payment deferrals, furlough and a moratorium on possessions, and the ultimate outcome of these in terms of credit losses is unknown. However, we do expect an increased number of customers to experience longer-term financial difficulties after these interventions have ended. Furthermore, despite a 20% increase in unemployment the number of customers in arrears has reduced, management believe the misscorrelation between arrears rates and unemployment is temporary and will correct itself when the furlough scheme comes to an end.

In order to recognise this increased risk, a management overlay of £1.5m has been included in the determination of ECLs and is held against loans in stage 2 which are deemed most likely to have experienced a significant increase in credit risk. This overlay is split between mortgage payment holiday customers: £0.3m (31 December 2020: £2.7m) and the misscorrelation between portfolio credit quality and unemployment rates: £1.2m (31 December 2020: £nil). As at 30 June 2020, balances were nil in respect of both overlays.

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

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

14. Credit risk (continued)

Portfolio	ECL Range Lower £m	ECL Range Upper £m	30 June 2021 £m
Retail financial services	5.8	12.5	8.9
Secured personal lending	3.3	5.9	4.4
Commercial lending	9.3	14.7	11.7
Total	**18.4**	**33.1**	**25.0**

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

	Group			
	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2021	5.2	18.7	10.5	34.3
Transfers:				
Stage 1 transfers	(0.1)	-	-	(0.1)
Stage 2 transfers	-	(2.6)	-	(2.6)
Stage 3 transfers	-	-	0.8	0.8
New loans	0.4	0.5	-	0.9
Settled loans	(0.5)	(1.5)	(1.0)	(3.0)
Changes in credit quality	(1.0)	(3.7)	(0.7)	(5.3)
Changes in loan model assumptions	-	-	-	-
Loss allowance at 30 June 2021	4.0	11.3	9.7	25.0

	Group			
	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2020	3.7	15.8	6.1	25.6
Transfers:				
Stage 1 transfers	(0.8)	-	-	(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 loan model assumptions	1.1	(2.3)	(0.2)	(1.4)
Loss allowance at 31 December 2020	5.1	18.7	10.5	34.3

14. Credit risk (continued)

ii) Commercial

Loans secured on commercial property are diversified by industry type with the largest exposure to one counterparty amounting to £26.9m (31 December 2020: £27.5m) or 3.5% (31 December 2020: 3.3%) of gross balances.

Asset quality remains strong with impaired balances of £11.9m (31 December 2020: £11.6m), or 1.5% of gross balances (31 December 2020: 1.4%).

iii) Treasury

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

Provisions for expected credit losses in relation to treasury instruments of £1.0m were held at 30 June 2021 (31 December 2020: £0.9m).

Responsibility statement

We confirm that to the best of our knowledge:

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

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

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

By order of the Board,

Julie-Ann Haines
Chief Executive Officer
4 August 2021

Independent review report to Principality Building Society

We have been engaged by the Principality Building Society (the "Society") to review the condensed set of financial statements in the interim financial report for the six months ended 30th June 2021 which comprises the condensed consolidated income statement, condensed consolidated statement of other comprehensive income, condensed consolidated statement of financial position, condensed statement of changes in Member's interests, condensed consolidated statement of cash flows and related notes 1 to 14. We have read the other information contained in the interim financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

Directors' responsibilities

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

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

Our responsibility

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

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the interim financial report for the six months ended 30th June 2021 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Use of our report

This report is made solely to the company in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Financial Reporting Council. Our work has been undertaken so that we might state to the company those matters we are required to state to it in an independent review report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company, for our review work, for this report, or for the conclusions we have formed.

Deloitte LLP
Statutory Auditor
Cardiff, UK
4 August 2021

Other information

The information for the period ended 30 June 2021 is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986. The financial information for the year ended 31 December 2020 has been extracted from the Annual Report and Accounts for that year. The annual accounts for the year ended 31 December 2020 have been filed with the Financial Conduct Authority.

The auditor’s report on the 2020 Annual Report and Accounts was not qualified and did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report.

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

Glossary

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

Glossary (continued)

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

ONLINE

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VISIT

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

CALL US

0330 333 4000•
(Open Mon–Fri 8am–8pm
Sat 9am–1pm)

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

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

Principality Building Society is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority, reference number 155998.
Principality Building Society, Principality Buildings, Queen Street, Cardiff, CF10 1UA.

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