ANNUAL REPORT
AND ACCOUNTS

2020

Building your future

Principality
Building Society
Cymdeithas Adeiladu

Where home matters
www.principality.co.uk

Key highlights of 2020

Total assets	Underlying profit before tax*	Net promoter score
£11.1bn	£24.1m	79.8
2019: £10.7bn	2019: £39.8m	2019: 81.5
Net residential mortgage growth	Savings balance increase	Residential mortgage balances
£182.2m	£596.1m	£8,175.7m
2019: £499.3m	2019: £598.7m	2019: £7,993.5m
Charity fundraising	Great Place to Work engagement score	Statutory profit before tax
£152,000	86%	£19.9m
	2019: 77%	2019: £39.6m

* Reconciliation can be found on page 19.

The above measures, apart from statutory profit before tax, are Alternative Performance Measures (APMs).
Further information on these APMs can be found in the Annual Report and Accounts, with definitions included within the glossary.

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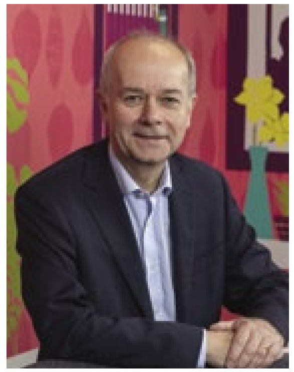
Meet the Board of Directors



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Strategic Report

Chair's Review of the Year

for the year ended 31 December 2020

I sincerely hope this report finds each of you in good health after a very challenging 2020 for us all. The Board and I are proud that our colleagues across the business still helped to meet the needs of our Members during the COVID-19 pandemic, including helping to implement more than 15,000 mortgage payment holidays when people most needed our support. Colleagues adapted brilliantly, despite almost 800 of them who are based in our Cardiff headquarters working from home since March 2020.

A special thanks must go to hundreds of our branch colleagues who served their communities for essential transactions right throughout this pandemic, handling difficult situations with great sensitivity. All our colleagues continued to operate with the highest professionalism and empathy that makes Principality stand out as an award-winning business for customer experience. I am proud the business remained strong and resilient enough to have kept everyone in employment and pleased no one was furloughed. The crisis was a real test of our operational resilience which we passed.

Pictured: Laurence Philip Adams, Chair

Performance

In terms of performance numbers, our assets have increased to more than £11bn and despite very challenging economic conditions, we achieved an underlying profit before tax[1] of £24.1m (2019: £39.8m) and statutory profit before tax of £19.9m (2019: £39.6m), further strengthening our capital base which is what gives us the ability to trade through tough times whilst still allowing us to invest for the future.

1. See reconciliation on page 19

As promised, we continued to invest previous profits back into the business to improve our technology so we could offer our Members improvements to their customer service. I am pleased we have been able to boost the security measures around our accounts and have been able to offer some innovative savings and mortgage accounts to first time buyers thanks to improved online measures. Our improvements to our technology also mean we can now make much quicker mortgage offers to our Members. All of our investment serves to make our business more flexible to meet the demands and needs of our Members. The Board and I are pleased to see that we are adapting to ensure we futureproof Principality so we can provide greater customer service for our current Members, while making the business relevant for future generations of Members.

Supporting our Communities and Members

Our work in financial education has once again been outstanding as we have helped educate thousands of young people about managing their finances. Taking our support online is also the way forward, particularly in the current climate, although I know our colleagues will no doubt once again provide classroom support as they have done for thousands of children in Wales, once they are allowed.

Our colleagues have also raised £152,000, which includes the business match-funding, for our two charity partners Alzheimer's Society Cymru and Teenage Cancer Trust Cymru, during the second year of our three-year partnership. We are always pleased as a Board to see colleagues making a difference to people who need our help the most. The decision to support our charities with an extra one off donation of £30,000 split evenly between the two charities once the pandemic had taken hold was the right thing to do because so many charitable organisations are struggling to stay afloat right now.

Governance

Principality is a member owned organisation. We particularly welcome therefore feedback from all of our Members whether it is via our branches, by telephone, email, letter, member forums or at the AGM. We are very focused on making sure we have insight into every aspect of our business with the highest standards of governance and that reflect the interests of all stakeholders.

There are quite a few farewells and welcomes for me to mention this year. Firstly, I would like to thank Mike Jones who acted as interim CEO for most of 2020 and welcome Julie-Ann Haines as our new CEO. Julie-Ann knows our business inside out, having been our Chief Customer Officer for many years. Mike returns to his former role as Chief Risk Officer.

We say goodbye to two long-standing employees: Peter Hughes, who has been the Managing Director of our Commercial business for 18 years, and mastermind behind the Mill in Cardiff which will see more than 800 homes built on an old brownfield site, more than 400 of them affordable rented homes. It is farewell also to Mike Borrill, our company secretary who is stepping down after more than 30 years working for Principality. There isn't much that Mike doesn't know about our business and his encyclopedic knowledge will be missed. On behalf of all our colleagues and Members, I want to say thank you for the enormous contribution you both have made to the Society.

I made a decision as part of our succession plans to step down from my role as Chair of the Board in April 2021 and I am delighted Sally Jones-Evans will be appointed as my successor, subject to regulatory approval, and will be our first ever female Chair. Sally's 30 years of experience in retail banking which involved leading people mainly in areas directly serving customers, made her the ideal candidate to take over as Chair. She has been a prominent Non-Executive Director Board member for the past five years and has a deep knowledge of the business and what matters to our Members.

This is another proud moment in Principality's rich history as we now will have our first female Chair, joining Julie-Ann Haines our first female CEO, working in tandem to take our business forward.

Future

On behalf of the Board, I want to thank our wonderful colleagues for their continued contribution to another successful year in very stressful circumstances. I am fortunate as the Chair to meet so many of our committed, professional and enthusiastic people and I know from these meetings that the Society is in excellent hands. I am so proud and privileged to have been part of this special organisation. Our business has grown from a balance sheet of £5bn to more than £11bn in the past eight years and has enabled us to grow our mortgage business. To double the size of our business over this period is a real achievement of which we should all feel very proud. Principality is in a robust position and will continue to provide a safe home for savings and help home owners get a home and stay in it for longer.

Finally, we would not be successful without the support of you, our loyal Members. I would like to thank each of you for continuing to choose Principality and wish you a healthy and prosperous future.

Laurence Philip Adams
Chair
16 February 2021

Pictured:
Principality colleagues helped raise money for charity partners and community projects in 2020

Pictured:
Indigo Bevan, Fiver Challenge 2020 Competition Winner

Chief Executive's Review of the Year

for the year ended 31 December 2020

In my first report as Chief Executive Officer, I would like to start by thanking our colleagues who have shown exceptional commitment to each other, our Members and communities over the course of the year.

Despite facing significant disruption and uncertainty this year, we maintained our award-winning customer service. During the first half of the year we had to deal with a number of operational challenges, not least enabling around 800 colleagues from our head office to work effectively from home. Our colleagues across the business helped more than 15,000 homeowners who needed a mortgage payment deferral, helping them to cope with the financial uncertainty created by the COVID-19 pandemic.

I want to thank all our senior teams who have worked hard to protect colleagues' physical and mental wellbeing to ensure that we could continue to provide essential services to Members in our local communities, with branches remaining open throughout. The strength and resilience of our business has allowed us to keep everyone in employment and not to furlough anyone.

Strong and resilient building society

Providing a safe and secure home for our Members' savings is fundamental to the ongoing success of our business and our aim is to continue to build scale, strength and resilience. As a building society owned by our Members we are not under pressure to meet the needs of shareholders by maximising profits; rather we want our Society to focus on the long-term needs

Pictured: *Julie-Ann Haines, Chief Executive Officer*

of Members, communities and society, helping people to prosper in their homes.

Last year, we signposted an expected reduction in profits in 2020 due to continued investment in technology to transform our core mortgage and savings operations. In addition, we have increased our provision levels by £9.1m (2019: release of £4.1m) to cover potential future losses arising from the economic downturn caused by the pandemic. Whilst no significant credit losses have been incurred to date, we recognise that some customers may experience financial difficulties over the next few years, and our conservative approach takes into account economic forecasts

Pictured: *Lucy from our Rumney branch, visiting the Llanrumney Hall Community Trust after the Rumney branch makes a donation to the local pantry service*

of factors including unemployment levels and property prices.

Principality has strong capital reserves but this conservative approach has had a significant impact on results for 2020, resulting in an underlying profit before tax of £24.1m (2019: £39.8m) and statutory profit before tax of

£19.9m (2019: £39.6m). This is a creditable performance given the economic conditions we have been operating in and the continued investment we have chosen to make in our technology platforms.

We have continued to grow our mortgage book but at a reduced level than in previous years. This growth has been funded by increased levels of Members' savings through a broader online product offering. Our retail mortgage lending increased by £182m this year (2019: £499m), taking total retail lending over £8bn for the first time, despite the UK housing market coming to a standstill for the best part of four months in the first half of the year. We have seen demand in the market increase during the second half of the year and we have a strong pipeline to start 2021.

The Bank of England base rate was reduced in March to an historical all-time low of 0.1% from an already low base. This has had implications on both mortgage margins and funding rates and as a result we have had to make some very tough decisions on savings rates to ensure that we continue to be financially sustainable, whilst continuing to invest in the Society. Despite this, we have increased the amount of savings we hold by £596m (2019: £599m), which has helped take our total assets above £11bn for the first time in our history.

Our Commercial team once again contributed in helping our communities, with work completed on the second phase of affordable homes at The Mill development in Cardiff. The team have now completed £55m of the £75m affordable housing fund established in 2018 and pleasingly this has seen take up from housing associations across all corners of Wales. We continue in our efforts to make housing more environmentally sustainable and are delighted to be supporting a number of house-builders through funding of solar powered and zero carbon homes.

Continuing to invest in technology

It is important we look to the future and continue our programme of investment in technology to further improve our award-winning service and broaden the range of products we are able to offer to our Members.

I am pleased that as a result of improvements to our technology we are able to offer a wider range of products available online, such as our NHS Thank You savings and mortgages for NHS workers in Wales, and First Home Steps savings account to help people save for a deposit for their first home. Our enhanced online security has made Members' accounts more secure, whilst a new web chat function has been added to improve the customer experience. Our ambition is to move at pace in the next few years to continue to invest in technology to improve our proposition and offer greater flexibility to our Members. We will continue to complement this with the outstanding branch service we operate in Wales and along the borders with England.

Stand-out experience

For the third year running, Principality has won the What Mortgage award for Best Building Society Customer Service and for the second year running we received Which? Recommended Mortgage Provider for Customer Service. This is reflected in the Society's Net Promoter Score[1] which is well above the sector average at just under 80% meaning almost 8 out of 10 of Members say they would recommend Principality to family or friends based on their level of satisfaction.

Colleagues supporting communities

Our people are our greatest asset and we strive to create a friendly, open and inclusive culture. It was wonderful to be acknowledged once again as one of the best places to work in the UK by Great Place to Work®. Our colleagues continue to make us stand out in the sector and are renowned for their warmth, personal approach and empathy.

I am very proud of the efforts our colleagues have made to improve the lives of others. As a purpose led business, we will continue to work hard to help our communities deal with the many challenges they face. This has included helping communities during the floods across Wales in February and providing support to projects during the pandemic, as well as donating £1,000 each to 10 different local charities across Wales selected by our colleagues.

Principality colleagues continued to find innovative ways to raise money for charity this year. With match funding from the business, a total of £152,000 was donated, split equally between Principality's two charity partners, Teenage Cancer Trust Cymru and Alzheimer's Society Cymru.

Principality has also partnered with Young Money for their Fiver Challenge which encourages the development of entrepreneurial and financial education skills for children, while raising money for local causes. More than 8,000 children signed up for this digital challenge through their schools and we hope to see many more take part in 2021.

New executive team

Since becoming CEO in September, a number of new colleagues have joined the Executive team and I am delighted that we could promote internally from our existing pool of talent with Tony Smith appointed as our Chief Governance Officer and Vicky Wales as our Chief Customer Officer. Both bring extensive experience from across the finance sector to their roles. I also appointed a new Chief People Officer, Lorna Kerr and Head of Strategy, Ben Joakim, both of whom will be huge assets to the business. These new additions to the Executive team join a highly experienced group of Executive Board Directors and together we look forward to taking your Society from strength to strength over the coming years.

1 We continually survey our customers and brokers who have had a recent interaction with our colleagues across Retail, Connect, Regulated Sales and Customer Services. In 2020, we received over 15,000 completed surveys, in which we ask our customers and brokers to rate on a scale of zero to ten how likely they are to recommend us to their friends and family, and from this we are able to create a Net Promoter Score, which is a measure of their satisfaction and relationship with Principality.

The Net Promoter Score is calculated by taking the proportion of respondents classed as Detractors (those rating 0 to 6) from the proportion of respondents classed as Promoters (those rating 9 or 10). In 2020, there were 84.2% of respondents who were classed as Promoters with just 4.4% of respondents being classed as Detractors.

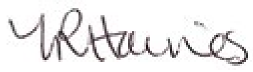
Thank you

I would like to say farewell to our outgoing Chair of six years, Laurie Adams, who will leave us at the end of April. Laurie has played a big part in overseeing our plans to grow the business and the outstanding customer service we continue to provide. His wealth of experience and knowledge has helped us to achieve this. We are grateful for everything he has done for our Members and colleagues during his time at Principality and wish him all the best for the future.

Outlook

We expect the economic environment to remain challenging in 2021 and beyond as the impact of the pandemic continues to be felt. In these difficult circumstances, I want to assure Members that Principality remains a safe home for their savings, and has the strength to resist the turbulence we are all facing.

Our strategy and long term priorities remain unchanged and, while our immediate focus remains on helping Members, colleagues and communities through these uncertain times, we remain committed to developing and growing our business in a safe and secure way. I would like to thank you, our Members, for the continued support you have shown the Society in 2020 and hope that you and your families are keeping safe.



Julie-Ann Haines
Chief Executive Officer (CEO)
16 February 2021

Business Model and Strategy

for the year ended 31 December 2020

Our purpose and vision

Principality Building Society was founded 160 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.

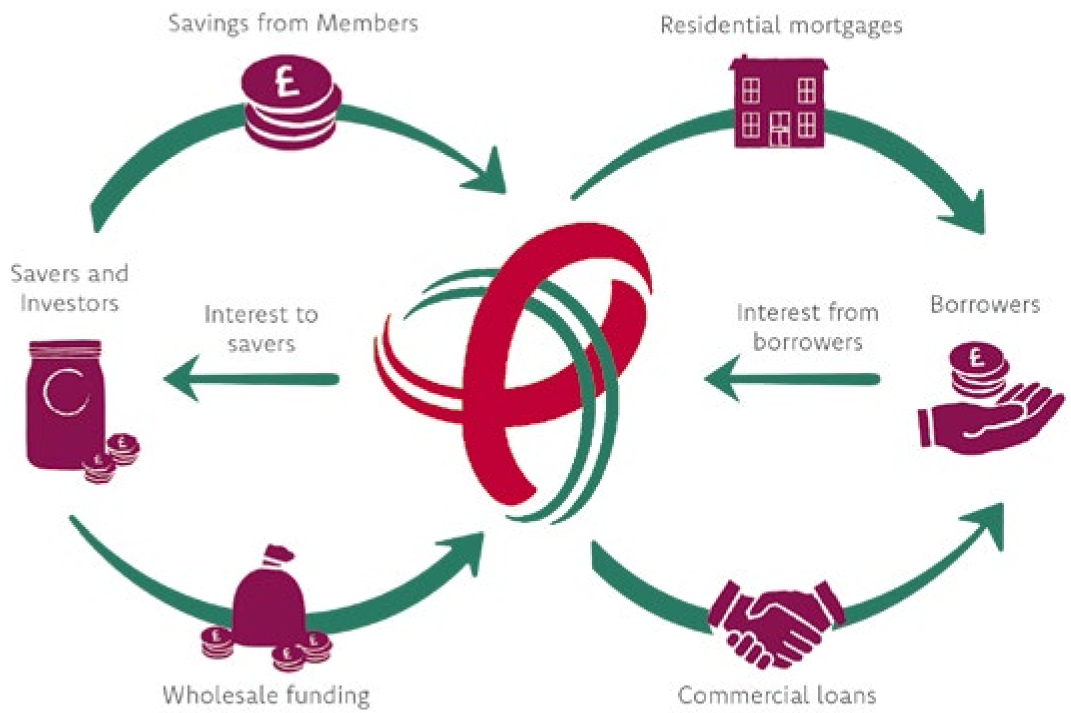
Our purpose and commitment to our Members also informs our strategic thinking and has helped us to develop our vision to deliver products and solutions that meet their current and future needs, allowing Members to do business with us through any channel that they want to – seamlessly. Achieving our vision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

Pictured: Llamau, The Wallich and Free Bikes 4 Kids each received a vehicle donation from Principality Building Society

Our business model

Our business model primarily operates across two lines of business: retail financial services and commercial lending, and our distribution channels allow us to reach customers through our 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 meaningful contribution to the group results. Additional contribution also comes from our range of complementary products of life insurance, home insurance and funeral plans, all with the goal of protecting Members over the longer term.

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 the business and technology to future proof our position and supporting community and charity projects through our branch and agency network. We do this to ensure we achieve our vision and deliver on our purpose, all whilst holding capital to safeguard the Society for future generations.



Our strategy

Our strategy helps us achieve our vision and deliver on our purpose. It clearly sets out our focus on our core mortgage and savings business, driving sustainable growth through customer focused propositions tailored to Member need, a commitment to service excellence, and the development of internal expertise all delivered through continuously improving processes and 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
"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 with our communities to provide support and create opportunities for them to prosper.	Net Retail Mortgage Growth Net Savings Growth Brand Consideration Cost Income Ratio
"We'll inspire **Brilliant People** across the Society with a customer focussed culture"	We'll be an employer of choice, 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
"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 Underlying Profit Before Tax Statutory Profit Before Tax Net Interest Margin Common Equity Tier 1 Ratio

Our progress

Over the last five years, we have focused on delivering our strategy, investing in a number of areas to improve the organisation. 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 differentiated products and services aligned to Member needs.

Commercial lending focus on supporting communities to prosper through funding of projects including care home facilities, residential developments, student accommodation and regenerational commercial development.

Continued growth of brand awareness through leveraging the sponsorship of Principality Stadium and the exposure generated by our involvement with the WRU.

Commitment to our charity partnerships during challenging economic times.

Winner of the Mortgage Finance Gazette award for Corporate Social Responsibility (lender category).

Brilliant People

Recognised as a Great Place to Work®.

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 values that align to our own.

Enhanced focus on equality, diversity and inclusion.

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

Stand-Out Experience

Named What Mortgage Best Customer Service for the third year running (2018, 2019 and 2020).

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

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

Our financial strength has enabled us to invest in activity aligned to our purpose, while ensuring that we maintain the high levels of service that our Members expect from us. We pride ourselves on the stand-out experience our Members receive from colleagues and we measure how well we are doing in this area through our Customer Service Net Promoter Score. The score measures the likelihood of a Member to recommend the Society to others, based on internally designed instant feedback surveys. Challenging conditions in 2020 have led to a small drop in our score from 81.5% to 79.8%; however, this is still a very strong performance and is testament to our ongoing commitment to providing a stand-out experience.

Transforming our Society

The COVID-19 pandemic has had a significant impact on Wales, the UK and globally in 2020 for both Members and 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 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 year. 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.

	2020 £m	2019 £m
Purpose Led Organisation		
Net Retail Mortgage Growth	£182.2m	£499.3m
Net Savings Growth	£596.1m	£598.7m
Brand Consideration	17.6%	16.4%
Cost Income Ratio	71.8%	69.4%
Brilliant People		
Employee Engagement Score	86.0%	77.0%
Stand-Out Experience		
Net Promoter Score[1]	79.8%	81.5%
Statutory Profit Before Tax	£19.9m	£39.6m
Underlying Profit Before Tax[2]	£24.1m	£39.8m
Net Interest Margin	1.00%	1.09%
Common Equity Tier 1 Ratio[3]	27.10%	26.20%

1. Source: Based on internal survey data for the 12 months ended 31 December 2020.

2. Reconciliation can be found on page 19.

3. 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 their intention to consult on the reversal of this change during 2021. Without this change, the group's CET1 ratio would have been 26.40% at 31 December 2020.

The above Key Performance Indicators, apart from Profit Before Tax, are alternative performance measures (APMs) which are internally used to inform with key management decisions. Further information on these APMs can be found in this Strategic Report, or definitions included within the glossary.

Pictured: Staff Members inside our new Hereford Branch

Pictured: Our Commercial team on site at the Great Farm House project in St Fagans

STRATEGIC REPORT

Financial Review

for the year ended 31 December 2020

Income statement overview:

Continuing Operations	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m
Net interest income	124.9	125.9	119.6	111.4	108.6
Other income	9.7	7.5	5.6	4.4	2.7
Fair value gains/(losses)	1.6	4.3	(2.4)	(0.2)	(4.1)
Operating expenses	(82.1)	(89.6)	(81.5)	(80.1)	(79.9)
Impairment provisions release/(charge)	2.7	10.0	(0.6)	4.1	(9.1)
Other provisions	(6.5)	(0.5)	-	-	1.7
Statutory profit before tax	**50.3**	**57.6**	**40.7**	**39.6**	**19.9**

Statutory profit before tax for 2020 has reduced from the prior year to £19.9m (2019: £39.6m). This reduction was driven by a significant increase in impairment provisions, with a charge for the year of £9.1m compared with a release of £4.1m in 2019. The increase in provisions against possible future loan losses is in direct response to the COVID-19 pandemic and takes into account economic forecasts of factors including unemployment levels and risks to residential and commercial property prices. Net interest income has also reduced, due to the continued run-off of the higher margin secured personal lending portfolio, together with continued competition in the mortgage market. Fair value losses have also increased year on year as financial markets have responded to concerns over the impact of the pandemic and the possible risk of negative interest rates.

Underlying profit before tax, which primarily excludes fair value movements and reflects the true trading performance of the business was £24.1m (2019: £39.8m).

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

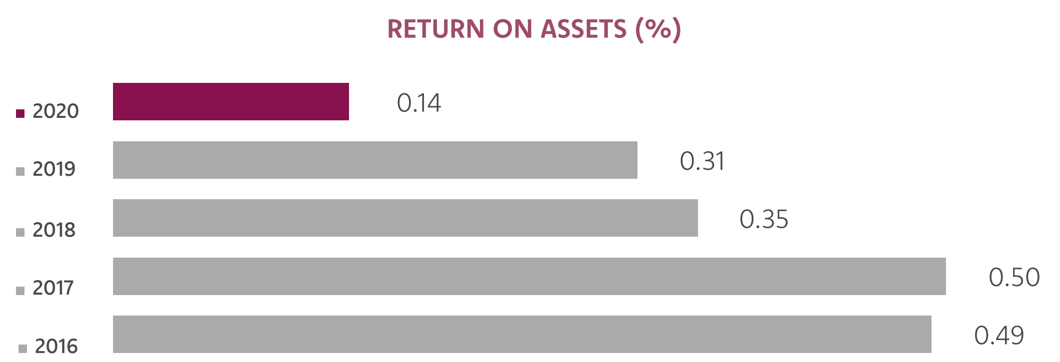
	2020 £m	2019 £m
Statutory profit before tax	19.9	39.6
Adjusted for:		
Fair value losses	4.1	0.2
Additional pension charge for GMP equalisation	0.1	-
Underlying profit	**24.1**	**39.8**

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, will reverse as the asset or liability approaches maturity and therefore trend to zero over time.

The additional pension charge for GMP equalisation relates to an increase in pension scheme liabilities following the recent court ruling with respect to former members of the defined benefit pension scheme that have transferred out.

Return on assets, calculated as statutory profit after tax divided by average total assets, has decreased compared with the prior year. This was in part expected as we continue to redeploy capital from secured personal lending to residential mortgage lending; however, has also been impacted by the increase in provision for loan losses and fair value losses in the year.



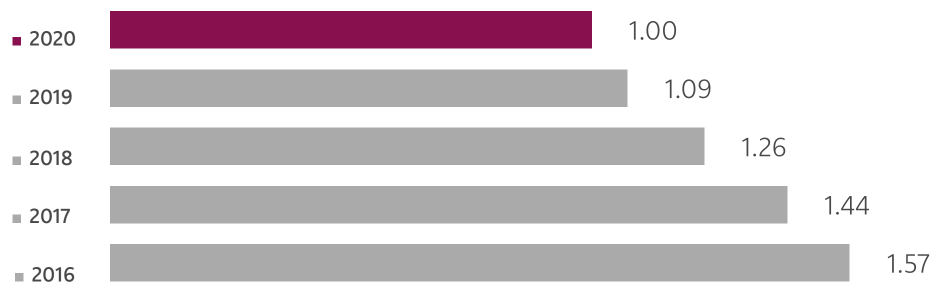
Net Interest Margin

Our net interest margin for the year was 1.00% (2019: 1.09%). This reduction from previous years has been impacted in part by a continued decrease in the secured personal lending portfolio. At the same time, and together with other financial services organisations, we have experienced further pressures on margin due to the ongoing competitiveness of the UK prime residential mortgage market, driving the continued replacement of older, higher margin loans with newer, lower margin lending.

Our lending continues to be primarily funded by Members' retail savings, with 88.9% (2019: 84.0%) 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. The reduction in the Bank of England Base Rate to an all time low of 0.1% in the year had implications on both mortgage margins and funding rates and, as a result, we have had to make some very tough decisions on savings rates to ensure that we continue to be financially sustainable.

In addition to the funding provided by retail savings, we aim to maintain a diverse range of funding sources. In 2020, we became a participant of the Bank of England's new Term Funding Scheme (TFSME), drawing down £350m of funding, and at the same time repaid £250m of funding previously drawn down under the 2016 TFS. Such forms of funding provide us with security over a longer-term and increased stability in uncertain market conditions.

NET INTEREST MARGIN (%)



Operating expenses

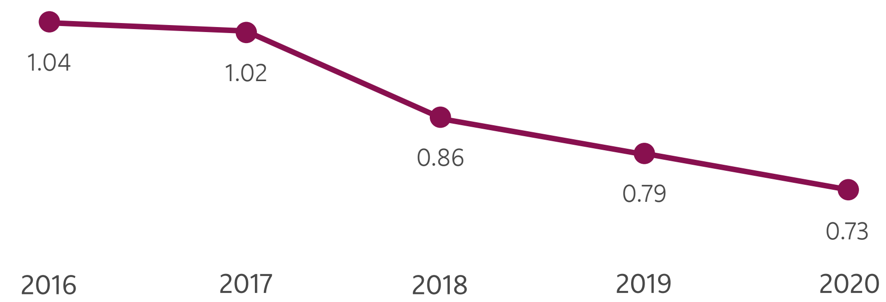
We recognise that operating efficiently is a significant factor in achieving optimal Member value, and as such operating expenses remain a key area of focus. We had anticipated an increase in operating expenses in 2020, due to continued planned expenditure on the group's transformation programme. Although this proceeded largely as expected, the onset of the COVID-19 pandemic meant that certain other expenses were lower than planned, particularly in relation to marketing and property costs. As a result, operating expenses marginally decreased in the year to £79.9m (2019: £80.1 m).

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

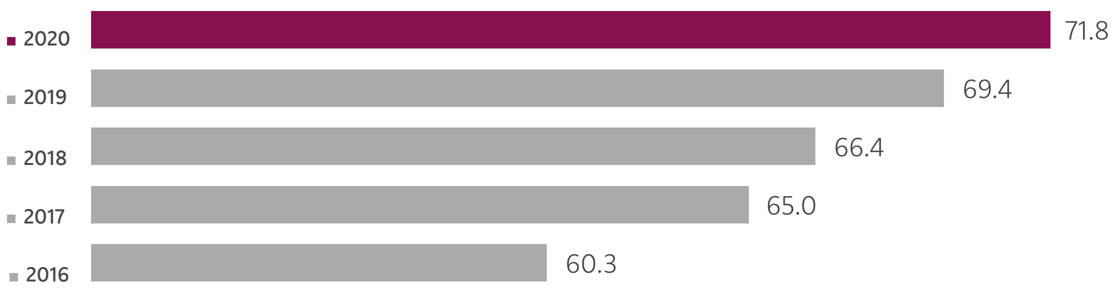
	2020 £m	2019 £m
Retail financial services	77.1	75.2
Commercial lending	2.5	3.6
Secured personal lending	0.3	1.3
Total operating expenses	**79.9**	**80.1**
Management expense ratio	0.73%	0.79%
Cost income ratio	71.8%	69.4%

The reduction in costs is reflected in a continued reduction in the management expense ratio, which compares costs as a proportion of the assets of the business. The cost income ratio has increased over the same period. This compares costs as a proportion of total income and overall total income, in particular net interest income, has reduced by a greater proportion than costs over the same period, for the reasons set out above. These key cost ratios will remain an area of focus in 2021 and beyond.

MANAGEMENT EXPENSE RATIO (%)



COST/INCOME RATIO (%)



Impairment provisions for losses on loans and advances

	2020 £m	2019 £m
Retail mortgage lending	1.7	2.1
Commercial lending	7.7	(2.7)
Secured personal lending	(0.6)	(3.7)
Treasury assets	0.3	0.2
Total charge/(release)	**9.1**	**(4.1)**

Impairment charges totalled £9.1m in 2020 compared with a £4.1m release in 2019. This is primarily due to increases in provisions for Retail and Commercial loans as a result of the economic uncertainty created by the COVID-19 pandemic. The decrease in provision for the secured personal lending portfolio is due to the continued run off of the loan book.

The group continues to have a low overall level of arrears, reflecting our prudent affordability, credit quality and underwriting standards. However, although there is now greater certainty as to the future trade relationship between the UK and EU following the conclusions of the trade negotiations in December 2020, there is significant uncertainty regarding the ongoing pandemic and its impact on the UK economy over the next couple of years, and the effect this may have on house prices, levels of employment and ultimately arrears levels over that time. 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.

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

	2020 £m	2019 £m
Retail mortgage lending	12.6	11.0
Commercial lending	15.8	8.0
Secured personal lending	5.9	6.5
Total	**34.3**	**25.5**

Provisions for liabilities

Regulatory provisions have been made in respect of various customer claims. At 31 December 2020, the group held a provision of £2.8m (2019: £4.4m). 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 2, 19 and 29.

Taxation

The effective tax rate for the group was 20.6% (2019: 19.0%) which is marginally above the statutory rate of 19.0% (2019: 19.0%) due to a prior year adjustment relating to tax relief on research and development costs incurred as part of the group's transformation programme.

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

Statement of Financial Position

Total assets increased by £425.1m to £11,120.9m, taking total assets above £11bn for the first time in the Society's history.

	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m
Liquid assets	1,116.8	1,320.0	1,112.5	1,569.6	1,807.9
Loans and advances to customers	7,073.9	7,864.1	8,498.7	9,033.1	9,204.9
Other assets	90.5	78.5	76.2	93.1	108.1
Total assets	**8,281.2**	**9,262.6**	**9,687.4**	**10,695.8**	**11,120.9**

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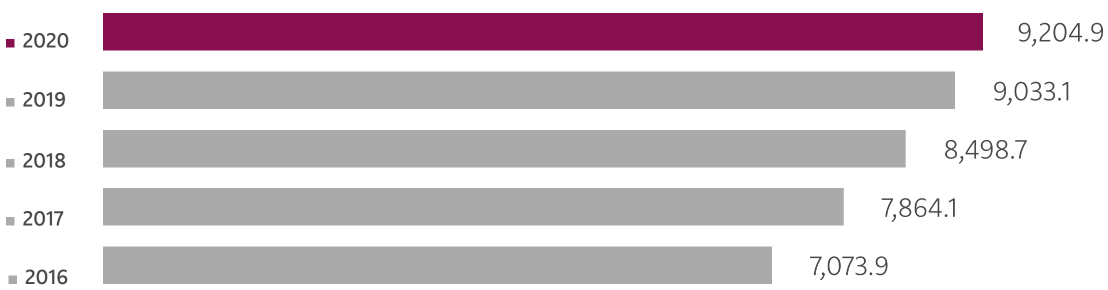
	2016 £m	2017 £m	2018 £m	2019 £m	2020 £m
Retail savings	6,165.2	6,563.8	6,989.8	7,588.5	8,187.4
Wholesale funding	1,468.8	2,035.9	2,019.4	2,378.1	2,200.1
Other liabilities	168.8	142.5	127.5	145.8	138.8
Total liabilities	**7,802.8**	**8,742.2**	**9,136.7**	**10,112.4**	**10,526.3**
Reserves	478.4	520.4	550.7	583.4	594.6
Total liabilities and equity	**8,281.2**	**9,262.6**	**9,687.4**	**10,695.8**	**11,120.9**

Loans and advances to customers

We have continued to focus on our core business of prime lending against residential and commercial property. This has delivered a net increase in loans and advances to customers of £171.8m (2019: £534.4m) to £9,204.9m (2019: £9,033.1m). Net retail mortgage lending in the year was £182.2m (2019: £499.3m). Gross retail mortgage lending was £1,226.9m (2019: £1,599.9m).

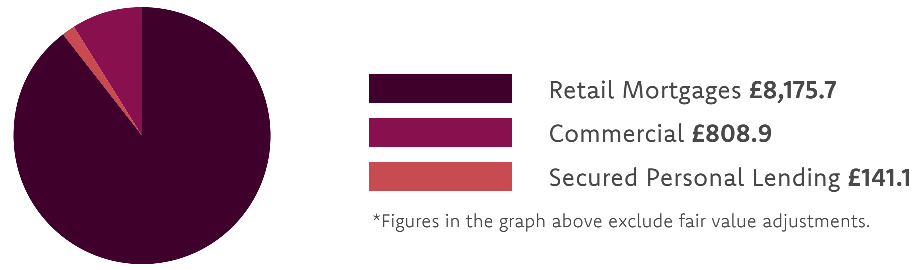
LOAN & ADVANCES TO CUSTOMERS (£M)



The retail mortgage portfolio has seen the majority of the increase to loans and advances to customers and remains the largest portfolio of the business at £8,175.7m (2019: £7,993.5m). This includes both lending to homeowners and a high quality buy-to-let portfolio of £2,269.2m (2019: £2,151.2m). 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 £141.1m (2019: £179.4m), secured against residential property by a second charge. This business is in run off with balances reducing by £42.7m (2019: £56.9m reduction) in the year.

LOANS & ADVANCES TO CUSTOMERS BY PORTFOLIO (£M)*



*Figures in the graph above exclude fair value adjustments.

Our retail mortgage and secured personal lending portfolios reflect the prudent nature of our lending policies, with 78% (2019: 76%) of exposures having a loan to indexed valuation of less than 75% and 94% (2019: 93%) 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 30.7% of lending (2019: 31.1%) 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 0.42% (2019: 0.42%) which compares favourably with the industry average of 0.83%*. The number of properties taken into possession during the year was 2 (2019: 35) due to the moratorium on possessions that was in place for much of the year. At the year-end 847 loans were subject to COVID-19 related payment deferrals, compared with over 15,000 at the peak.

The percentage of secured personal loans currently in arrears of two months or more by number is 8.35% (2019: 4.72%), which by value is 9.56% (2019: 5.92%). The significant increase on the prior year is due to the moratorium on possessions as noted above which, although it can give customers time to find alternative solutions to financial difficulties, has also resulted in more people staying in arrears for longer. At the year-end 130 loans were subject to COVID-19 related payment deferrals, compared with over 1,000 at the peak.

The commercial lending portfolio is made up of commercial property exposures representing 36.1% (2019: 36.1%) of balances, and lending against residential property and to registered social landlords of 63.9% (2019: 63.9%). The Society provides loans secured on commercial property across England and Wales, with 46.7% (2019: 47.3%) of lending situated in Wales.

The commercial lending portfolio had five exposures greater than three months in arrears at the year-end (2019: three) with a balance of £0.3m (2019: £0.7m). 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. At the year-end, 21 loans were subject to COVID-19 related support, compared with 126 at the peak. There are no arrears in respect of lending to registered social landlords.

** UK Finance arrears and possession data at 30 September 2020.*

Defined benefit pension scheme

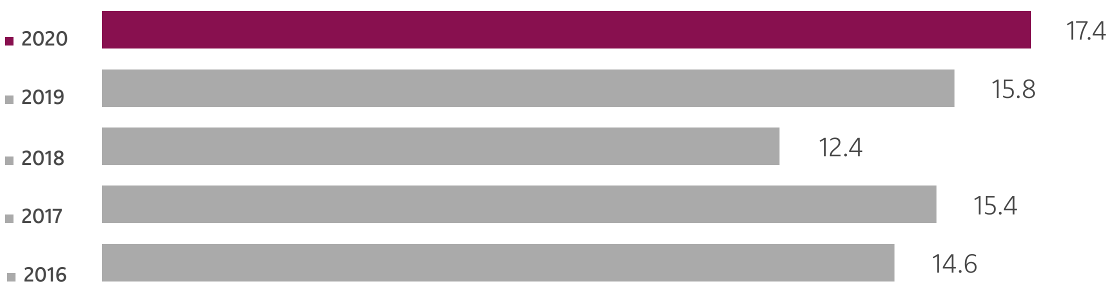
The Society operates a defined benefit pension scheme, which is closed to new entrants and to further accrual. During the year, the pension scheme deficit (the difference between the scheme assets and scheme liabilities on an accounting basis) increased to £2.7m (2019: nil), due largely to falling corporate bond yields, which form the basis of the rate used to discount the scheme's liabilities. The impact was reduced by contributions made by the Society in the year of £3.1m (2019: £3.7m).

The scheme is subject to a triennial valuation by the scheme's independent actuary. The most recent valuation, with a reference date of 30 September 2019, was completed as planned during 2020. The 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 17.4% (2019: 15.8%) as a proportion of shares, deposits and loans (SDL). Liquidity levels at the end of the year were higher than anticipated, having been impacted by high savings inflows in the final months of 2020, but a slowdown in mortgage completions due to further lockdown restrictions. Liquidity levels are expected to reduce during 2021 as we complete on loans in the mortgage pipeline and repay some of our wholesale funding.

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 82.7% (2019: 86.6%). Of the total liquid assets, none (2019: 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 206.8% at the year end (2019: 223.1%), 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:

	2020 £m	2019 £m
Cash and balances with the Bank of England	1,438.5	1,201.9
Securities issued by the UK Government and Multilateral Development Banks	50.9	141.3
Total Buffer Eligible Assets	**1,489.4**	**1,201.9**
Loans and advances to credit institutions and other debt securities	318.5	226.4
Total	**1,807.9**	**1,569.6**

Funding

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

Funds are raised from a variety of sources in order to meet the strategic objective of maintaining a diversified funding mix. The largest component is retail savings, which at £8,187.4m (2019: £7,588.5m) represent 88.9% (2019: 84.0%) of all mortgage and loan balances. Retail savings balances have increased by £596.1m in the year (2019: £598.7m), reflecting the continued focus on offering attractive products to Members.

In 2019, we completed our fifth and sixth RMBS issuances, raising £665m of funding. These issuances supported our strategic objective of maintaining a diverse and balanced funding base. Due to robust levels of liquidity throughout 2020 no further issuances were undertaken. The total value of RMBS notes outstanding at the end of the year was £665.6m (2019: £805.3m).

During the year we have maintained our credit ratings on our long-term and short-term debt with both Moody's and Fitch, albeit the outlook has been changed from stable to negative in line with much of the sector during 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	Negative
Fitch	F2	BBB+	Negative

Asset encumbrance

We use our assets as collateral to support the raising of secured funding, primarily as part of the RMBS issuances or pledged under the terms of Bank of England funding schemes. At the end of the year, 22.7% (2019: 23.3%) of the group's assets were encumbered, representing £2,263.4m (2019: £2,288.2m) of residential mortgage assets and £256.2m (2019: £198.9m) of other assets.

Capital

We hold capital to protect Members' deposits by providing a buffer against unexpected losses. The amount of capital required is assessed in relation to our overall risk appetite, the material risks to which the business is exposed and the management strategies employed to manage those risks. At 31 December 2020, capital comprises the group's general reserve, adjusted in line with regulatory rules, which qualifies as Common Equity Tier 1 capital, the very highest quality of capital. In the prior year, capital also included the group's subscribed capital (Permanent Interest Bearing Shares, or PIBS) which qualified as Tier 2 capital. The PIBS were redeemed in full on 1 June 2020.

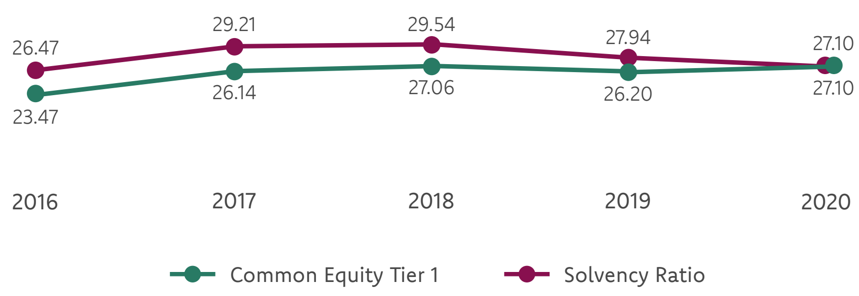
Our primary measure in assessing capital adequacy is the Common Equity Tier 1 (CET1) ratio, which expresses the highest quality capital as a proportion of the sum of the risk weighted assets of the group. The risk weighting for each asset is calculated either through the use of internal models or through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

Our CET1 ratio has increased to 27.10% in the year (2019: 26.20%). This increase has been driven by a marginal reduction in the level of risk attributed to certain loan assets, including the impact of house price increases in the second half of the year. It has also been impacted by changes in the capital regulations, which allow for a smaller deduction from capital for intangible assets than in prior years. This change is subject to further consultation by the PRA during 2021 and may be removed. Excluding this change the CET1 ratio at 31 December 2020 would have been 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 facilitate the increase in lending to households and businesses.

Following the redemption of the PIBS, as described above, our Solvency ratio, the ratio of total capital to risk weighted assets, is now consistent with our CET1 ratio, at 27.10% (2019: 27.94%).

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 5.15% (2019: 5.21%). This measure has also been impacted by the changes in capital regulations described above and, subject to further consultation by the PRA during 2021, may be removed. Excluding this change, the leverage ratio at 31 December 2020 would have been 4.98%.

Member, Colleague and Community

for the year ended 31 December 2020

Community work

It has been a tough year for our communities as first the flooding in the early part of the year and then the COVID-19 pandemic has impacted enormously upon the welfare of families, vulnerable individuals and businesses, as well the charities we support. Our wonderful colleagues have done their best to help those most in need of support.

Charity partnerships

- More than £152,000 was raised for our two charity partners in 2020 - Teenage Cancer Trust Cymru and Alzheimer's Society Cymru.

- Since the partnerships started in 2019, colleagues have raised over £297,000 split equally between the two charities. All funding is going towards the Dementia Connect Service in Wales and the TCT Unit at the Heath Hospital in Cardiff.

- Over £2,000 was raised for BBC Children in Need 2020 with our CSR Manager taking part in the BBC Countryfile Rambles.

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Financial education

Just over

10,000

children and young people have benefitted from our financial education activities in 2020.

Another

1,172

children gained other LIBF qualifications, including Lessons in Financial Education (LiFE).

This figure includes the Fiver Challenge, with more than

7,200

Primary Pupils across Wales taking part, putting their entrepreneurial skills to the test and setting up their very own mini businesses with purpose. 2020 was our first year of sponsorship of the Fiver Challenge in Wales and we look forward to working with Young Enterprise again in 2021.

Strade School in Llanelli became a recognised Young Money Financial Education Centre of Excellence in 2020. We funded their involvement in this programme which helps build a financial education culture across the school and the wider community.

Our sponsorship in secondary schools saw

1,466

school children across Wales gain the Level 2 Certificate in Financial Capability and Career Development with the London Institute of Banking and Finance (LIBF). This qualification is a GCSE equivalent.

Volunteering

- Colleagues have volunteered more than 250 hours in 2020 to support community projects. The majority of this involved supporting schools before lockdown in March.
- Towards the end of 2020 we started helping our charity partner Alzheimer's Society Cymru with their companion call programme, which sees colleagues phoning people who live with dementia, to give them company.
- We tried to help in local communities as much as possible and in very different ways this year too. We donated three of our maintenance vans to good causes, two going to homeless charities Llamau and The Wallich to help with their outreach activities, and another one going to the Free Bikes 4 Kids Community Project which aims to provide kids, schools and key workers with bikes. We have also donated 100 new cycling helmets to the project on behalf of our branches in Newport and Cwmbran.
- During lockdown we donated 150 rugby balls and 41 footballs to children - to help them keep up their skills and health.
- We donated 26 tablets to help keep schools and people connected and support online learning.

Members

We pride ourselves on listening to our Members so colleagues can understand how to meet their needs and expectations. Members tell us that they value the friendliness and helpfulness of our colleagues.

The Member Forum is made up of volunteer members who act as a collective voice for all Principality members. They attend meetings on a quarterly basis to share their views and tell us what they think of our products, initiatives and to help us make the right decisions for all our members. The forum has had significant and valuable input into the continuing strategy of the Society and we thank all of our forum members for the advice and support they have given us this year.

Principality also engages with its Members in a number of other ways:

- At the Annual General Meeting, Members have the opportunity to vote and put questions to the Board. Our AGM this year was made available online for our Members to meet government social distancing guidance.
- In normal circumstances, Principality's senior leadership team holds regular Talkback events all over Wales and the Borders but due to government guidance that was not possible. Instead we held a virtual update in December to introduce Members to our new CEO, Julie-Ann Haines.

Sponsorship

Due to the pandemic the events we would normally sponsor, such as the Royal Welsh and Eisteddfod, were sadly cancelled. We understand this may have been a disappointment to some of our Members and are working on our plans for Summer 2021.

As proud partner to Welsh Rugby and sponsor of Principality Stadium and the National Youth Leagues for grassroots clubs in Wales, our Members did benefit from ticket competitions and access to tickets for the Guinness 6 Nations games that took place at Principality Stadium before lockdown.

We felt it was important to bring cheer to our rugby communities, running a competition for a virtual clubhouse quiz, hosted by Welsh World Cup referee Nigel Owens. Pembroke Panthers RFC were the lucky winners, with players winning prizes donated by the WRU, including tickets to Welsh Internationals at Principality Stadium, signed rugby shirts and balls, and tickets for a tour around Principality Stadium when guidance permits.

Despite Principality stadium being used as a temporary field hospital, we felt it was important to acknowledge that Principality Stadium is – and will always be – the home of Welsh Rugby. During the Autumn Nations Cup, we encouraged the nation to cheer on from their own homes, giving

STRATEGIC REPORT

away supporters packs, designed to recreate a traditional match-day experience from home, to lucky Members, as well as rugby clubs in Wales who had been impacted severely by the floods in February 2020. It was our way of bringing a piece of Principality Stadium to homes across Wales and encouraging sofa supporters stretching from Cardiff to Conwy.

We hope 2021 will give us more opportunity for our Members to enjoy our sponsorships.

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

Our colleagues are one of our greatest assets and the aim of our people strategy is to deliver continuous improvements in colleague engagement and satisfaction. With the challenges presented by the COVID-19 pandemic in 2020, the safety and wellbeing of our colleagues has been paramount, particularly with a significant proportion of our workforce running our branch network. Supporting our people has never been more important.

Our people strategy 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 focussed 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 are incredibly proud of our colleagues. Through our People Pact, we are committed to helping our colleagues prosper at every stage of their working lives. We believe that if we are able to help our colleagues prosper, we will see them increasingly strive to support our Members and our business in the same positive way.

Recognised as a 'Great Place to Work®' in the super large companies category 2020, we are committed to building on what our colleagues tell us they enjoy about working in our organisation and we work hard to address their feedback around what we can improve.

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 committed 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 and uphold the right culture for our organisation.

Colleagues are encouraged to recognise each other 'in the moment' and value cards are available at all of our working locations for colleagues to gift to each other when they see demonstration of our values.

Forming the basis for our individual business objectives, our values are prominent throughout the Society and are also recognised through quarterly and annual recognition celebrations. Given the challenges presented during 2020, our celebrations were held virtually this year.

We respect our colleagues as individuals: our diversity and inclusion approach

As a business, we are clear that having a diverse workforce that is representative of and reflects the communities we serve is crucial to our ongoing success. Encouraging diversity throughout our business remains a priority and we have been pleased to see a positive take-up amongst our colleagues for a number of diversity-focussed initiatives, including a female leadership development programme delivered by Chwarae Teg and our LGBT+ and Friends and REACH (Race, Ethnicity and Cultural Heritage) networks. From Board level down, we are clear that diversity helps to improve the quality of decision making throughout our organisation and we are committed to increasing our diversity spread to further support our ambitions. 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. Further details are available at:

www.principality.co.uk/gender-pay-gap-and-women-in-finance

Over the past year, we have again worked closely with Stonewall to ensure we can do everything possible to help all colleagues feel comfortable, safe and able to be themselves at work. We have also worked extensively on our recruitment process, introducing gender de-coding, blind shortlisting and gender balanced interview panels, ensuring that protected characteristics are championed throughout. We have recently appointed a Diversity and Inclusion manager who will continue to shine a light on this area and hold us to account on doing what's right for our colleagues and for the good of our organisation.

Recognising that no two colleagues are the same, we offer a flexible benefits package allowing our colleagues to select the benefits that are most meaningful to them from a range including private medical cover, dental cover, holiday buy and sell, will writing, travel accounts and much more.

Colleagues are encouraged to bring their whole selves into our working environments and initiatives such as 'dress for your diary' along with a range of colleague networks and a colleague forum have further encouraged celebration of our differences and ensured colleagues continue to have a voice in our organisation.

We encourage expertise: investing in our talent to realise potential

As our business transforms, our people focus remains a constant. We are passionate about developing our colleagues and we have a strong learning culture with a clear focus through our People Pact around helping our colleagues to prosper at every stage of their working lives. Our Leadership Pipeline provides a clear pathway for colleague learning and development throughout the organisation and initiatives such as our 'Learning at Work' week and networking group, 'Cuppa Club', which has attracted guest speakers including BBC newsreader, Lucy Owen and radio and television presenter, Jason Mohammad, provide even more opportunities for informal learning and development. We recognise that no two colleagues will approach their development in the same way so in addition to our specialist talent management programmes, we also have a range of secondments and graduate schemes designed to support colleagues, whatever their career aspirations. Our Accelerated development programme, which focuses on our leaders and building their skills and experience so they can lead and support our workforce with increased knowledge and expertise, continued throughout 2020, and we also rolled out a similar 'Aspire' programme for our people managers.

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

At Principality, we work hard to listen and respond to our colleagues and we are proud to have a highly engaged workforce. Colleague surveys are an important enabler to hearing our colleague voice and we have introduced a number of initiatives to respond to feedback gathered, including our PBS Manager training for all people managers, our skills exchange and a mentoring scheme. We continue to utilise our colleague forum, ensuring we have a direct voice from our colleagues into our Board. The forum is a great vehicle to ensure our colleague voice is heard in all key matters within the Society. With so many of our colleagues working remotely in 2020, listening and being able to respond to their feedback has been instrumental in maintaining our culture.

We have run multiple 'pulse' surveys throughout the year to keep in touch with views and sentiment and in October 2020, 79% of our colleagues took part in our latest Great Place to Work® survey to share their views on working life at the Society.

The survey is run by an independent third-party and the responses gathered are used to define scores in key outcomes including Engagement, Trust and Wellbeing. The 2020 survey showed that engagement remains strong at 86% (2019: 77%). The results of the survey are reviewed in detail and actions developed in response and delivered both at a team and Society-wide level. Colleagues are encouraged to share their views and feedback year-round and there are a number of open and anonymous feedback routes available.

Wellbeing

We have a long-established wellbeing approach that aims to promote both mental and physical health amongst our colleagues. With a wide ranging wellbeing-focussed offering, including interventions from free eye tests to investment in our mental health advocates and a full Employee Assistance offering, we work hard to support our colleagues through their best times and their more challenging times.

In July 2019, we were delighted to be awarded with the Corporate Health Standard, part of the Welsh Government's 'Healthy Working Wales' programme with a purpose of encouraging and enabling the development of good practice in the promotion of health and wellbeing in the workplace. In addition, in November 2020, we were recognised as a centre of Excellence in Wellbeing by Great Place to Work® for the second year running.

The wellbeing of our colleagues has been brought into sharp focus in 2020 and we have ensured that they have felt fully supported throughout via a range of initiatives designed to supplement our existing offering. From a weekly corporate fitness programme to a virtual choir to informal virtual coffee morning discussions on menopause and men's mental health, there's something for everyone and we work hard to encourage everyone who is interested to get involved.

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, which is linked to a combination of the Society's success, 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 are passionate about our communities and our Corporate Social Responsibility efforts have won awards for our 'Responsible Business' practices, but we know that as we grow, the resources we use increase, with a potentially greater environmental impact. As protecting our environment becomes ever more important to us all, we are continuing to work on becoming more efficient in the amount of energy we consume as a business, increasing the effectiveness of recycling programmes and improving colleague awareness of environmentally responsible behaviour such as reducing paper, energy and personal car use.

The COVID-19 pandemic has had a big impact on our energy usage during 2020. Our flexible working policy had already enabled more colleagues to work from home where appropriate, reducing the need for unnecessary travel. This increased further with the onset of the pandemic, and we have expanded our remote working technology to the extent that we currently have more than 700 of our head office staff working from home.

At the same time, we have tailored our operational properties that have been impacted by home working to ensure we maximise our energy efficiency during this period through our building management system. Whilst we do expect a return to the office when allowed, we expect that colleagues will make greater use of remote working in the future.

Energy efficient working environments

We know from our carbon footprint that heating, lighting and general electrical use are the main contributors to our energy usage, so we are continuing to work hard to reduce their usage across our property estate. An important part of this work involves identifying any anomalies or areas of high-usage and raising awareness about the best way to use existing systems to reduce energy consumption. In October 2020, we moved to a 100% renewable energy supplier that will power the entirety of our head office and branch network for at least the next two years.

We have introduced a number of energy saving initiatives across our branch network too, including LED lighting and updated technology systems which are being utilised in two of our newest branches in Newport and Hereford (which opened in November 2020) and we are proactively looking at rolling out this technology to the rest of our branch network, beginning in 2021.

Reducing waste and recycling effectively

Managing waste effectively is an important area of focus for us. We provide all colleagues working in our offices and across the branch network with access to recycling points and non-recyclable waste is passed to a third party for conversion to energy where possible. Our overall waste levels in 2020 reduced by 51% compared with the prior year, albeit we recognise this has been impacted by many colleagues working at home. We have though seen printer paper use drop by 95% and, with minimal remote printing functionality, this is an important step in reducing our paper use in the future.

In August 2020, our lease on the former Nemo head office building ended and we vacated the property. As part of the process we reused much of the office equipment in our recently renovated Friary building and where this was not possible, we engaged with third parties to refurbish the equipment for charitable donations for use in local communities.

Energy-efficient technology

We regularly review our technology and IT usage to identify where we can reduce energy consumption. Desktop PC's and laptops continue to be replaced with more energy efficient equipment when required and old equipment is recycled either through donation or through an appropriate recycling unit.

We utilise video conferencing technology which is used by colleagues and customers alike to reduce transport and optimise time that would usually be spent travelling to appointments / meetings. This has reduced the need for non-essential travel for customers and colleagues alike, with the software being utilised to hold face to face appointments from the comfort of our customers' homes, and internally to allow head office colleagues to work from home. Since March 2020 all of our Board and Committee meetings and staff training have taken place virtually.

Environmental champions

We have a group of 17 Environmental Champions from across all areas of our business, who are all passionate about making Principality a greener workplace. The role of our Environmental Champions is to:

- Raise awareness of what Principality is doing to reduce its environmental impact
- Help empower colleagues with the knowledge they need to reduce their own impact on the environment whilst at work
- Highlight key initiatives, awareness days, and share general tips and advice on how to be greener at work
- Represent colleagues on our Colleague Forum to ensure the topic of environment stays at the forefront of key decision-makers and influencers at Principality
- Communicate ideas about initiatives that the Society can adopt to reduce its impact on the environment through identified channels to reach all levels within the Society.

The next key initiative for the Environmental Champions will be an Environmental Awareness week in 2021 in which the ambassadors will share tips and guidance on how to adopt greener habits for colleagues.

Environment priorities for 2021

- We will be working with our partners to complete our obligations under the government's Streamlined Energy & Carbon Reporting (SECR) initiative. As a business we are fully supportive of the approach and will carefully review the output during the course of the year, so that as an organisation we increase awareness and understanding of our energy costs so we can make informed decisions in the future.

- We are beginning work on our head office building, Principality House, parts of which have not been updated since the office was originally built 30 years ago. The work will include upgrading the electrical infrastructure and mechanical installations including ventilation, heating and air conditioning throughout the building, and we will be incorporating the latest technologies for maximum efficiency and minimal wastage.

- We anticipate home working for many of our colleagues to continue to be the norm for much of the first half of the year as the COVID-19 vaccination roll out gathers pace. We have a project underway focused on how we bring colleagues back to the office and how we shape our working practices in the future to allow people to flexibly balance the benefit of the office environment with remote working by utilising the technology we now have in place. Environmental considerations will be a core part of our thinking to ensure that any changes we make enhance our sustainability as a business.

- We will be appointing a new Sustainability Manager, reporting to the Chief Risk Officer, who will be focused on making Principality a more sustainable organisation, both in terms of our carbon footprint and the products that we offer. The role will also include the development of our environmental strategy and risk appetite, particularly in relation to the financial risk of climate change.

KPIs

To measure our progress we monitor the following KPIs:

	2018	2019	2020
Road Miles Travelled	413,171	353,479	101,505
Energy Usage (KwH)	4,116,543	3,947,920	3,581,007

Risk Overview

for the year ended 31 December 2020

As a business, we are 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 the prior year, but in many respects their potential impact on the inherent risk profile of the business is elevated as a consequence of the challenges and uncertainty arising as a consequence of 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. 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 is 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 is a humanitarian crisis that has affected lives and livelihoods across all corners of the globe. It has forced the closure of national and regional economies, causing hardship for many. The virus remains active and dangerous. The full scale of the economic damage caused by national and local lockdowns has not yet fully manifested itself, and predictions of the speed and scale of the economic recovery are tempered by the ongoing possibility of further lockdown measures. Intervention by the UK Government to encourage job retention has averted immediate increases in the unemployment rate. However, as these schemes unwind and households and businesses face into the reality of increased levels of uncertainty and anxiety in the near term, our plans and forecasts are tested on a range of plausible outcomes that include larger movements in interest rates, further 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 is within our risk appetite. As the COVID-19 pandemic has taken hold within the UK we have kept our lending criteria under constant review, restricting loan to value (LTV) and loan to income (LTI) criteria where appropriate, as well as ensuring that our assessment of affordability takes account of the unusual circumstances that some applicants have found themselves in. Even as interest rates have fallen, we have continued to assess affordability using a stressed, higher interest rate to protect the borrower from entering into a mortgage commitment that could prove unsustainable in a higher interest rate environment. We do not lend to retail borrowers outside of the UK prime first-charge mortgage market.

Lending is secured against properties in the UK. This 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. These stress tests 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. Along with most UK mortgage lenders, we have offered customers the opportunity to apply for an emergency payment holiday. We have encouraged 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. In response to the COVID-19 pandemic, we have opted to focus our attention on supporting our existing customers and their businesses. 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 adversely affected by the crisis.

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. The Treasury function is responsible for managing this aspect of credit risk 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.

STRATEGIC REPORT

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

The COVID-19 pandemic has had a significant impact on the global economic and political landscape in 2020, resulting in high levels of volatility in capital and money markets.

Whilst the UK economic outlook remains uncertain, the Bank of England (BoE) package of measures introduced in March 2020 has provided stabilising injections of funding and liquidity into the UK financial system.

Access to cheap funding through the Term Funding Scheme with additional incentives for SMEs (TFSME) and the wider effects of the BoE's Quantitative Easing program has limited the Society's exposure to funding and liquidity risks during a highly volatile period in the UK economy.

In addition, the Society has a strong track record of attracting and retaining retail funds and external credit ratings continue to support the Society's access to wholesale funding markets.

(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 October 2020.

The Society maintains a diverse funding base, offering a range of retail products whilst maintaining a presence in the wholesale market. As a member of the Sterling Monetary Framework, PBS has access to TFSME and has previously utilised its predecessor (TFS) as part of its funding strategy.

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.

(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.

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 a prolonged low interest rate environment, or the possible 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 present value (PV) of the balance sheet.

(ii) Market background and uncertainties

With Bank of England Base Rate at an already historic low of 10bps, there is still potential for rates to reduce further, with negative rates not being ruled out by the BoE's Monetary Policy Committee. Pre-COVID-19 market expectations were that interest rates would remain lower for longer and the case for this is even stronger given the uncertainty in the UK recovery and ongoing post-Brexit trade negotiations.

The London Inter-Bank Offered Rate (LIBOR) is to be phased out by the end of 2021. The Society will be impacted due to exposures to LIBOR assets and liabilities, particularly in the commercial lending portfolio and associated derivatives.

(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.

The Society is closely monitoring the market and the output from various industry working groups managing the transition to new benchmark interest rates and has set up a LIBOR transition programme under the governance of the Chief Financial Officer. The aim of the programme is to ensure the Society transitions its current LIBOR exposures, including Commercial loans and associated interest rate swaps linked to LIBOR, to an alternative benchmark rate by the end of 2021. Work began on the project in 2019 and has progressed throughout 2020 to ensure the Society achieves a smooth transition by the required deadline.

(iv) Currency risk

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

STRATEGIC REPORT

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 or 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.
Physical assets, safety and security	The risk of loss arising from the ownership, management and security of, and threats to, the property and facilities used by the Society.
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 the pandemic. Whilst the external environment continues to evolve with challenges associated with technological innovation, increased customer expectations and emerging regulatory standards, the sector is also dealing with the additional operational risk associated with the current pandemic. For example, the move to home 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 now includes activity that exploits the COVID-19 pandemic and the resulting uncertainty surrounding this issue. 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.

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 above. In addition to any direct loss attributable to risks in these categories, the reputational impact of such an event may damage the Society leading to secondary impacts.

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

The 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 and capital management

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 which is much better capitalised than prior to the 2007 Financial Crisis and the regulatory landscape continues to evolve as CRD-V and CRR-II are adopted. However, the COVID-19 pandemic introduces significant uncertainty into the future growth trajectory of the UK economy and whilst the Society can expect capital to be absorbed by losses, regulatory authorities have also applied a number of changes designed to support firms during the stress.

(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 August 2020.

STRATEGIC REPORT

(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 additionally 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 (www.principality.co.uk) in April 2021.

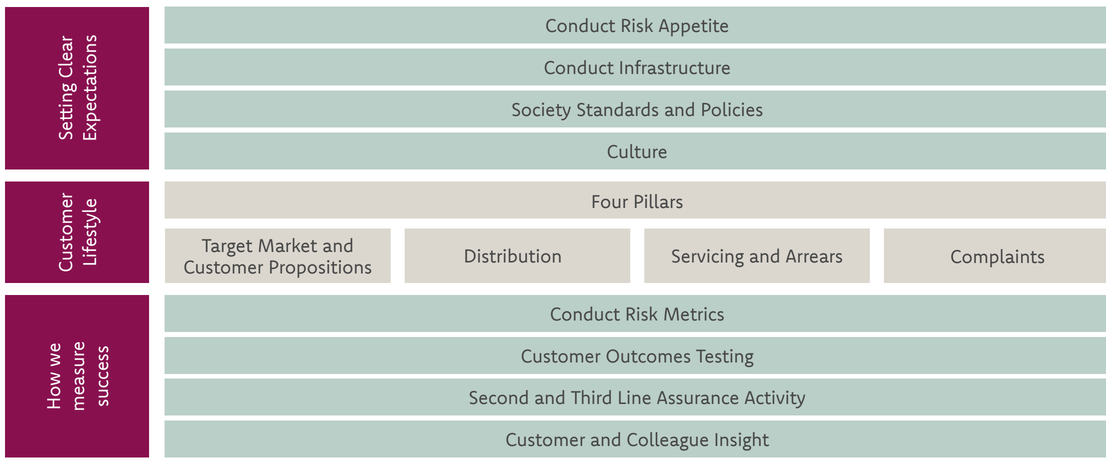
g) Conduct risk

(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 on 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 helping mortgage customers and savers is aligned to our regulators' expectations.

(ii) Risk mitigation

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



The Conduct Strategy sets out our strategy for managing conduct risk and also articulates the Board's risk appetite in relation to conduct risk. The Conduct Strategy is considered and approved on a triennial basis, unless earlier review is warranted by material changes in the external environment or in our strategy.

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 current and emerging 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 which would have a material impact on our business model. The most significant emerging and evolving risks to our strategy are detailed in the table below, 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. Current uncertainty in the macroeconomic environment is being driven by a number of factors, the most significant of which are the impact of the COVID-19 pandemic 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.	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 possible long-term impact of the pandemic on the core markets in which we operate, together with the potential outcome of the UK's exit from the EU. These include, but are not limited to, the stress test scenarios published by the Bank of England.
Competitive environment The nature of, and demand for, financial services has altered significantly over recent years. In particular, this has been characterised by the development of innovative digital products offered by new entrants, as well as more established institutions. Acceptance and utilisation of digital technology appears to have increased significantly following the onset of the 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.

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.	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.
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 both within the UK and wider markets, and operational disruption arising as a consequence of the global pandemic. These attacks represent a material risk to the provision of services to Members as well as to Member data.	We continue to develop our cyber risk management capability alongside the investment in our core product offering. We continue to regularly review the availability of preventative and detective controls.

Approval of the Strategic Report

This Strategic Report (on pages 4 to 49) has been approved by the Board of Directors and is signed on behalf of the Board by:

Tom Denman
Chief Financial Officer
16 February 2021

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		

Laurence Philip Adams MA
Chair, Non-Executive Director GNC RC
Joined the Board in August 2013, elected Chair in April 2014

Skills and experience
I am a qualified solicitor with more than 25 years' experience in the banking industry, which helps advise and guide the Society through the increasingly demanding and complex regulatory environment in which it now operates. Previously, I have been involved as a Non-Executive Director helping to rescue the troubled Northern Rock PLC in 2007 where I headed the Risk Committee.

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

Other roles
Director of Outside Insight Ltd and Non-Executive Director of London Clearing House Limited, part of the London Stock Exchange.

Nigel Charles Annett CBE, MSc, MA [Hons], DSc Econ
Independent Non-Executive Director TC BRC 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 in Wales.

Claire Hafner ACA, MA
Independent Non-Executive Director
AC RC GNC
Joined the Board in April 2018

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

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

Other roles
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 Anthony Howell BSc [Hons], FCA
Senior Independent 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 continue to act as a consultant for PwC solely in connection with the ongoing administration of Lehman Brothers.

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
Treasurer of St John Cymru Wales and a trustee of both the National Botanic Garden of Wales and Artes Mundi.

Sally Jones-Evans FCIB, MSc, MBA
Independent Non-Executive Director, Chair Elect
RC GNC AC TC
Joined the Board in February 2015

Skills and experience
I spent 30 years in retail banking at Lloyds Banking Group, during which I gained wide ranging experience in leading customer facing business areas through significant change including the branch network, Commercial Lending and general insurance. I believe that helps me to support the Executive Leadership team to shape the Society's ongoing strategic agenda.

Contribution to the Society's long-term sustainable success
I am particularly interested in how our culture underpins the sustainability and success of the Society. As Chair of the Remuneration Committee, I am responsible for ensuring that the Society's remuneration and reward strategy, policy and procedures support the strategy approved by the Board reflecting the best interests of Members and enabling the Society to attract and retain the best people.

Other roles
I sit on the Boards of Hafren Dyfrydwy Ltd (a subsidiary of Severn Trent PLC) and Saga Services Ltd, the insurance broking arm of Saga Group PLC. I also serve as a Trustee of Tearfund, the humanitarian and overseas development charity and as a Non-Executive Director on the Board of Delio Wealth Ltd, a fast growing Welsh FinTech business.

David James Rigney ACMA, MBA, MA
Independent 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 a 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 environments 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
Independent Non-Executive Director
GNC TC
Joined the Board in September 2019

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

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

Other roles
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.

Robert Michael Jones BA [Hons], MBA, ACIB
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, 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
Whilst Interim CEO, I was responsible for leading the Executive team to ensure we continue to deliver the Society's strategy for the long-term interests of our Members in addition to maintaining the smooth running of the Society's day-to-day operations. As CRO, together with the CFO, I am responsible for ensuring the Society maintains a strong capital base which will enable it to continue to grow and compete successfully over the long-term. I also have responsibility for the Society's second line of defence to ensure risk management is embedded throughout and aligns to the Society's risk appetite, purpose and objectives.

Other roles
Member of the UK Finance Mortgages Product & Service Board

Julie-Ann Haines MSc, BA [Hons]
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. 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.

Iain Mansfield, LLB [Hons], FCA
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, in addition to retaining overall responsibility for Nemo. 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.

Tom Denman, BSc Econ [Hons], ACA
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 the long-term interests of our Members and the sustainability of the Society.

Corporate Governance Report

for the year ended 31 December 2020

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 2020.

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 and monitoring progress against the agreed strategy.
- Ensuring that there is an appropriate culture in place across the Society which aligns with its purpose, values and strategy. 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.
- The proper conduct of all aspects of the Society's affairs.
- Fostering transparency and honesty and ensuring that good standards of behaviour permeate throughout all levels of the Society.
- 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 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.
- Approving significant projects, such as the Society's transformation programme. The Board delegates oversight of this particular programme to the Technology Committee.
- 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.

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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:

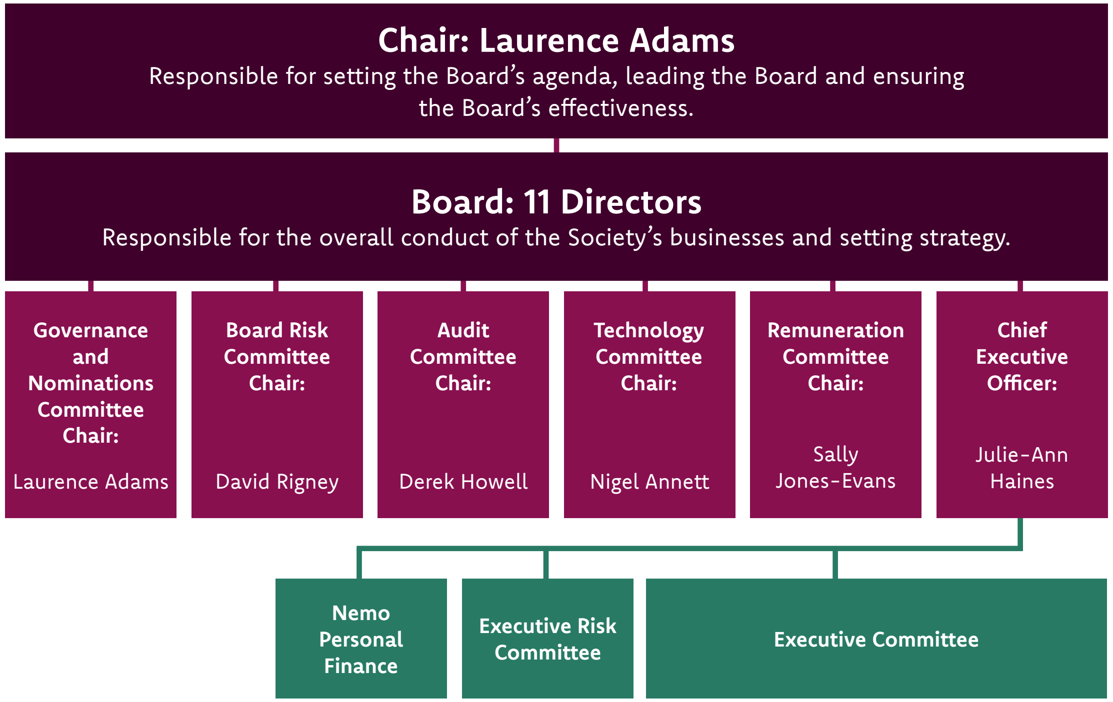
Responsibility	Key Activity
Standing Agenda Items	• Management information pack to facilitate the monitoring of Key Performance Indicators and Key Risk Indicators. • Reports from the Chief Executive Officer, Chief Financial Officer and Chief Risk Officer on performance and risk matters, including non-financial information. • Reports from the Board Committee Chairs on key matters considered and decisions made at the last Committee meeting.
Strategy	• Medium Term Plan • Approval of Corporate Plan • Marketplace Developments • Macro-economic assumptions • Brexit Planning • Business Model Review • Differentiation Strategy Review • Information Security Strategy • Transformation Programme • Digital Strategy Review
Financial Reporting and Performance	• Long-term Viability Statement Review • Approval of 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 • COVID-19 Response Planning

Responsibility	Key Activity
People, Culture and Remuneration	• People Strategy • 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 – Responsibilities Map • Approval of Treasury Policy Statement • Wholesale Funding Decisions • Lending Policies
Governance	• Adoption of Part II to Schedule 10 of the Building Societies Act 1986 and Sections 68 & 69 of the Statements and Elections • 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 • 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: www.principality.co.uk. In addition, the Board also maintains a schedule of matters which are reserved for its decision which is also subject to annual review and is available on the website.

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



Board Composition

Under the Society's Rules, the Board must comprise no more than 14 and no less than 7 Directors and, under the UK Code, at least half of the Board should comprise Non-Executive Directors. At 31 December 2020, 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 68 to 69.

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	14/14	-	-	7/7	-	4/4
Derek Howell	14/14	8/8	5/5	-	-	4/4
Sally Jones-Evans	14/14	8/8	-	7/7	7/7	4/4
David Rigney	14/14	8/8	5/5	-	7/7	4/4
Nigel Annett	14/14	-	5/5	7/7	7/7	4/4
Claire Hafner	14/14	8/8	-	7/7	-	4/4
Debra Evans-Williams	14/14	-	-	-	7/7	2/4
Julie-Ann Haines	12/14	-	-	-	-	-
R Michael Jones	14/14	-	-	-	-	-
Tom Denman	13/14	-	-	-	-	-
Iain Mansfield	14/14	-	-	-	-	-

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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 9 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 his appointment as Chair, the Board was satisfied that Laurence Adams met the independence criteria as outlined within the UK Code. The Chair's role requires him to commit a substantial proportion of his time 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

During the year, Julie-Ann Haines was appointed Chief Executive Officer. Further information on her appointment is provided within the Governance and Nominations Committee report on pages 68 to 69.

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 recruitment process can be found in the Report of the Governance and Nominations Committee on pages 68 to 69.

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 2020 AGM.

Culture

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

Due to the onset of the COVID-19 outbreak, 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 Forum, 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. More regular colleague surveys took place during 2020 as a consequence of the COVID-19 outbreak with the results of those surveys being passed through to the Board.

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

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members of senior management, new Non-Executive Directors also have the opportunity to attend key management meetings and to visit areas of the business.

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

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

The Society's Secretary maintains an ongoing Board training and development programme and during 2020 the following areas were addressed:

- asset and liability risk management;
- legal and regulatory developments;
- corporate governance developments;
- economic environment;
- marketplace developments;
- diversity and inclusion;
- management of commercial loan book exposures and conditions in the commercial real estate market;
- cyber security;
- IRB model developments;
- funds transfer pricing;
- climate change risks; and
- operational resilience.

Individual Performance Evaluation

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

The Chair is responsible for assessing annually the fitness and propriety of the Society's independent Non-Executive Directors and the Chief Executive Officer. The Senior Independent Director is responsible for leading the evaluation of the Chair's performance, in conjunction with the other Non-Executive Directors, and for conducting his 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 2020 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. The last external Board Effectiveness Evaluation was undertaken in the final quarter of 2018 and was performed by Praesta Partners (a firm of specialist corporate advisors) who have no other relationship with the Society. The next externally facilitated Board Effectiveness Evaluation is due to be undertaken during Q4 2021. The 2020 Board Effectiveness Review was facilitated by the Group Secretary. As noted in the 2018 report, the principal finding arising from the 2019 review was that the Board continues to fulfil its governance role strongly. The themes arising from the review which resulted in action being taken to further strengthen Board governance included, but not limited to:

- Further strengthen succession planning and to 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 management information while reducing its volume.

Progress with work to implement the actions arising from the 2019 Board Effectiveness Evaluation has been regularly monitored by the Board and the Governance and Nominations Committee.

At the end of 2020, the Society's Secretary commenced the internal Board Effectiveness Review which was facilitated through the use of a structured questionnaire. Feedback within the questionnaire is due to be discussed by the Board at a collective roundtable discussion in the New Year, in order to form an action plan for 2021.

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 2020 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 Forum	Offer good value and flexible savings accounts and mortgages
	Retail Savers	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/LGBT Forum/REACH 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 29 to 32	Be a sustainable business and act as a socially responsible organisation
Environment	Members, Regulators and communities in which the Society operates	The Society's Chief Risk Officer has been designated by the Board as the Senior Manager responsible for managing the financial risks associated with climate change A new Sustainability Manager has been appointed, reporting to the Chief Risk Officer Establishment of an internal 'Environmental Network', sponsored by the CEO Internal assessments made in line with the UK Streamlined Energy and Carbon Reporting (SECR) framework	Understand the importance of taking steps to minimise the impact of the Society's operations on the environment

The Society has continued to develop our colleague engagement framework further during 2020. As part of this work, Claire Hafner attends 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 impact of the COVID-19 outbreak 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 LGBT+ colleague group and has heard directly from members of that forum about how the Society can become a more inclusive place to work.

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 is committed to fostering and maintaining good communications with Members. During the year, 5 meetings were held by the Members' Forum, most of which were operated virtually due to COVID-19 restrictions, and we delivered the first virtual Member Talkback in December, the learnings of which are being applied to our Annual General Meeting.

Attended by a number of the Society's Executive Directors, these meetings provide valuable means for Members' opinions about the Society to be canvassed directly by members of the Board, who receive regular reports on the matters being considered by the Member Forum.

In 2021, we are launching a much larger Member Panel, made up of approximately 4,000 Members via an online platform. 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. We are in discussion with existing Forum members on their role within the panel moving forward, and expect to have the panel operational in the first half of the year.

All Directors who stood for election or re-election in 2020 were duly elected or re-elected. All Directors will again stand for election or re-election at the 2021 AGM, with the exception of Laurence Adams who will retire from the Society's Board following the conclusion of the 2021 AGM.

The Society seeks to encourage all eligible Members to participate in the AGM, either by attending in person where possible, or by 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 2021 AGM is being held virtually due to ongoing restrictions resulting from the COVID-19 pandemic.

Laurence Philip Adams
Chair
16 February 2021

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Governance and Nominations Committee Report

for the year ended 31 December 2020

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.

During the year, the Committee appointed Warren Partners (who have no other relationships with the Society) to support the process which led to the appointment of Julie-Ann Haines as the Society's new Chief Executive Officer.

In September, Laurence Adams announced his intention to retire from the Society's Board in April 2021. The Committee appointed Miles Advisory LLP (who have no other relationships with the Society) to lead the recruitment process which resulted in the selection of Sally Jones-Evans (subject to regulatory approval and successful re-election by Members at the Society's 2021 Annual General Meeting) to succeed him as the Society's Chair. The process for appointing a new Chair was led by Derek Howell as the Society's Senior Independent Director together with those Non-Executive Directors who had opted to take part in the appointment process and the Chief Executive Officer. Following a robust process, the Committee was satisfied with the selection process and endorsed the proposed appointment at its December 2020 meeting.

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.
- Reviewed the mix of the skills and experience on the Board.
- 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.
- Conducted a review of the corporate governance framework within which the Society operates.
- 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 2019 internally facilitated review of the Board's own effectiveness and that of its committees.

As Chair I continue to be satisfied that each Non-Executive Director has the requisite knowledge and skills to be able to discharge their responsibilities effectively.

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%. At 31 December 2020, 36% of Board members were female. The table below shows the ratio of women to men in senior management positions within the Society compared with the target set by the Board:

Diversity Target Ratio (September 2021)	Ratio as at 31 December 2019	Ratio as at 31 December 2020
33.3%	31%	31%

A new Diversity and Inclusion Lead has recently been established, reporting to the Chief People Officer. Work is underway to refresh the Society's existing Diversity and Inclusion Strategy. The key aspects of that strategy encompass promoting a culture that enables diversity and inclusion to be embedded across the organisation, adopting recruitment practices that attract, retain and promote diverse candidates, raising awareness and understanding and developing skills in diversity and inclusion, raising the profile of diverse role models, promoting and supporting employee network groups and ensuring that there is no diversity bias in rating the performance of colleagues.

C. P. Adams

Laurence Philip Adams
Chair of the Governance and Nominations Committee
16 February 2021

Board Risk Committee Report

for the year ended 31 December 2020

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 2020, the Committee comprised three independent Non-Executive Directors, David Rigney, Derek Howell and Nigel Annett. 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 Enterprise Risk Management Framework & Policy • Annual review and approval of Treasury Policy Statement & Retail & Commercial Lending Policies • Annual approval of Compliance & Conduct Risk Management Policy & Conduct Monitoring Plan • Approval of Cyber Risk Penetration Testing Programme
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 • Co-ordination and implementation of scenario-based 'playbook' risk management exercise for 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 COVID19 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
16 February 2021

Audit Committee Report

for the year ended 31 December 2020

The Audit Committee assists the Board in fulfilling its oversight responsibilities in respect of matters relating to financial reporting, systems of risk management and 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.

Committee membership

The Audit Committee is a Board Committee and in 2020 comprised four independent Non-Executive Directors, Derek Howell (Chair), Sally-Jones Evans, David Rigney and Claire Hafner. The Committee met on eight occasions during the year.

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

The Committee regularly invites the Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, Chief Internal Auditor 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 and/or estimates 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 COVID-19 outbreak. As part of that assessment the Committee has had regard to a range of forward looking macro-economic scenarios and in particular the actions taken by management to mitigate the potential risks connected with a fall in house prices through curbing the appetite for credit risk across the retail, buy-to-let and commercial loan book portfolios.

- Impairment provisions on loans
  During the year the Committee has closely monitored the output from the IFRS 9 impairment provision models and the performance of the Society's loan books. The level of impairment suggested by the models and the assumptions which inform the models are key areas of accounting estimate. 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. In addition, the Committee has monitored the impact of the COVID-19 outbreak on the performance of the Society's loan books, in particular from loans subject to payment holidays and changes to macro-economic assumptions and the 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 estimate 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 provision 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.

In addition to these areas of focus, the Committee recognises that hedge accounting remains a particularly complex area of activity, and the onset 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 has considered the methodology adopted by management leading to the calculation of fair values for derivative instruments including compliance with requirements for hedge accounting for those instruments. The Committee is satisfied that appropriate accounting entries have been made in the financial statements for this purpose.

The Committee has also considered the capitalisation of intangible assets in the context of the Society's transformation programme. The Committee has considered the requirements of IAS 38 and the need to recognise intangible assets, provided the relevant criteria is satisfied. Having considered the criteria, the Committee concluded that it was satisfied with the assumptions used to capitalise qualifying expenditure.

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. 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.

Assessment of internal controls

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 control environment is designed to evolve as the risks faced by the Society change over time. The Committee is responsible for monitoring and ensuring the operating effectiveness of those controls. This 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 and his team which is designed to reflect a risk based approach, having regard to the risks embedded in the Society's operations. The Committee receives regular reports on the operating effectiveness of the systems and controls framework including financial controls, internal control and risk management systems. As part of the reporting process, the Chief Internal Auditor provides the Committee with a summary of the most significant matters being monitored by the Internal Audit team and items of thematic interest which warrant the Committee's attention.

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 also held private meetings with each of the Chief Internal Auditor and Deloitte during the year. In addition, the Committee also monitors the effectiveness of the Internal Audit function. This work includes monitoring the progress of the Internal Audit team against the Audit Plan and reviewing progress with work to implement audit recommendations. During the year, the Committee received a report on the effectiveness of the Internal Audit function from the Chief Internal Auditor and has reviewed the Internal Audit Charter.

In response to risks arising from the COVID-19 pandemic, the Internal Audit Function:

- Fully appraised the audit universe to consider additional and/or augmented risks faced by the Society and amended the audit plan accordingly.
- Agreed with the Committee a temporary change to the Internal Audit framework which facilitated faster assurance without compromising quality.
- In conjunction with the second line, monitored any agreed control relaxations and ensure that, in any relevant audits, these were reviewed and challenged.
- Developed the 2021 audit plan with the longer term impacts of COVID-19 in mind.

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.

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. Members of that team are responsible for the overall co-ordination, verification, detailed review and challenge of the content of the Annual Report itself. The Committee receives assurance from members of the Executive team that they consider the content for which they are responsible is fair, balanced and understandable. The Committee also receives an early draft of the Annual Report to enable members of the Committee to conduct a timely review and challenge the content of the report. The Committee is committed to continually improving the transparency of reporting to the Society's Members.

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.

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 current audit partner has now completed his fourth year, and accordingly is due to be replaced following the conclusion of the 2021 external audit.

Following the completion of an open tender process, Deloitte were re-engaged as the Society's external auditors in December 2016. The Audit Committee has previously agreed that it will consider whether to undertake a new tender where the incumbent auditor has served a further term of five years, and this review will therefore take place during 2021.

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 £480k. Non-audit fees, mainly in relation to further assurance services, were £66k

Other matters

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

Derek Howell
Chair of the Audit Committee
16 February 2021

Technology Committee Report

for the year ended 31 December 2020

The Technology Committee is responsible for providing oversight of the Society's technology transformation programme 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 2020 comprised four independent Non-Executive Directors: Nigel Annett, Sally Jones-Evans, David Rigney and Debra Williams. The Committee met on seven occasions during the year.

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

Activity during the year
During the year, the Committee 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 first, second and third line teams.
- Independent assurance reports received from DMW Group. DMW Group 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 platform and to improve the experience of Members using that platform.
- Progress with work to implement a new mortgage applications processing platform. A phased implementation approach for the new platform has been adopted. The initial pilot phase commenced in August 2020. Having set clear criteria for judging the success or otherwise of the pilot phase, it is expected that this phase of the roll-out of the new mortgage applications processing platform will be completed in the first half of 2021.
- Regular updates from the Executive Sponsor on both the Mortgages and Savings work streams, which form the technology transformation programme.
- Regulatory change which could impact any of the individual components of the transformation programme.
- Resource requirements including ensuring that colleague capability had been enhanced and ensuring that the impact of the COVID-19 outbreak on colleagues through the transition to remote working arrangements was allowed for within the transformation programme.
- Internal and external readiness for the launch of the new systems, ensuring ongoing stakeholder engagement.
- The methodology which supports the capitalisation of expenditure incurred in respect of the transformation programme.

Following each Technology 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.

Nigel Annett
Chair of the Technology Committee
16 February 2021

Remuneration Committee Report

for the year ended 31 December 2020

The Remuneration Committee

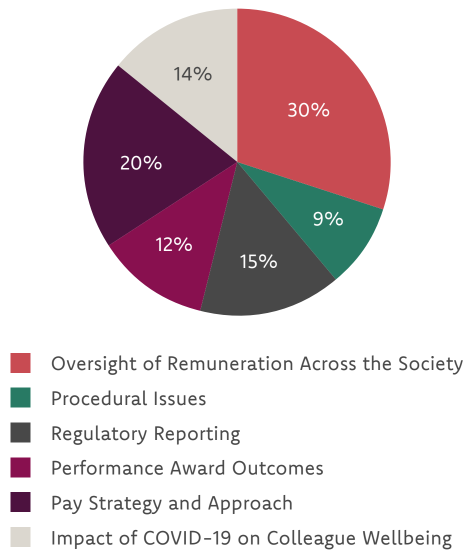
Membership of the Remuneration Committee during 2020 remained consistent and comprised:

- Sally Jones-Evans – Chair of the Committee and Non-Executive Director
- Laurence Adams – Chair of the Board
- Nigel Annett – Non-Executive Director
- Claire Hafner – Non-Executive Director

A significant proportion of the Committee's time throughout 2020 has been dedicated to:

- Setting appropriate pay for Executive appointments, for both the permanent new Chief Executive Officer and Chief People Officer, and the Interim Chief Executive, Chief Risk and Chief People Officers.
- Ensuring benefits provision for Executives is fair and reflects the external market, with pension contribution levels for new appointments brought in line with those of the workforce, alongside the removal of car allowances for new appointments to both Executive and senior leadership positions.
- Tracking actions to improve the Society's diversity and inclusivity.
- Understanding and overseeing the Society's approach to supporting colleagues through the COVID-19 pandemic and into the future, with a particular focus on their wellbeing and support to work from home.

PROPORTION OF TIME SPENT BY THE REMUNERATION COMMITTEE



Performance in 2020

As outlined in other sections of this report, the Society's financial performance has inevitably been impacted by the economic effects of the pandemic. Mortgage growth is lower than recent years and has been delivered in the most challenging of circumstances, with lockdown affecting the housing market for a significant part of the year. However, we saw demand increase during the second half of the year and we have a strong pipeline of applications going into 2021. Savings balances also increased during the latter part of the year, driven largely through our online channels and demonstrating the benefits of the investment we have made in our technology. Due to concerns over the ongoing economic effects of the COVID-19 pandemic, profitability levels have been reduced by provisions for future bad debts.

Notwithstanding this, the Society is in a strong position to endure an economic downturn. Our capital and liquidity levels remain strong and in excess of regulatory requirements, and we are well positioned to weather the current challenging economic and market conditions. With 160 years of heritage, we've survived difficult times in the past and our business is stronger for it. We continue to keep a close eye on external factors and react accordingly to protect our business for today and tomorrow.

As a mutual, we are not motivated by short term profit and instead we make decisions for the long term interests of the Society. A key focus has been supporting and reassuring our Members and despite the circumstances and challenges we've faced, feedback continues to be positive, resulting in high net promoter scores and external awards.

In 2020, we continued to invest in digital technology to further improve our award-winning service and broaden the range of products we offer. In March we launched our new and improved online platform, Your Account, which provides enhanced functionality and new security features, and in August, we launched the first phase of our new mortgage platform to our broker customers. We will continue to invest in digital capability to ensure we remain competitive and relevant to current and future 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.

During the year the Committee continued to use PwC to provide independent advice on executive remuneration and benchmarking information. PwC are also appointed to provide the Society with advice on taxation matters and Derek Howell (Senior Independent Director) continues to act as a consultant for PwC.

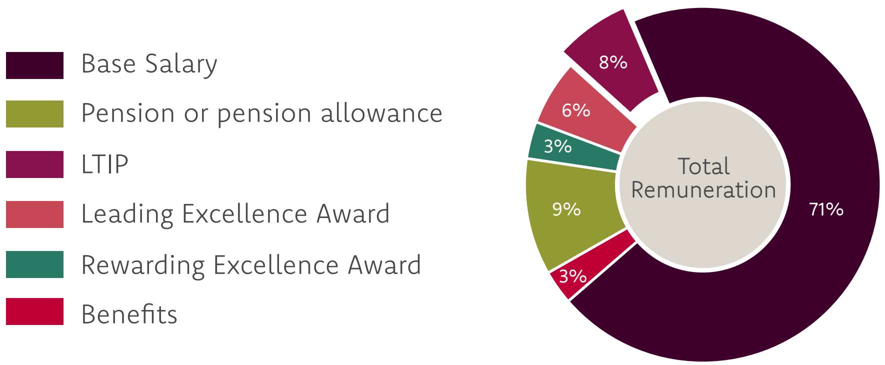
The Remuneration Committee is satisfied that the remuneration policy operated as intended throughout 2020.

How this policy is applied

The table below provides a summary of the different elements of remuneration for Executive Directors in 2020:

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 car allowance, family private medical insurance, critical illness cover and life assurance.
Pension or pension allowance	To provide for longer-term savings to fund retirement. Pension contribution of 15% of base salary or equivalent cash allowance.
Rewarding Excellence Award	Designed to share the benefits of teamwork, financial discipline and customer service with all colleagues. Providing a maximum award payment 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 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.
Long term incentive	The Long-Term Incentive Plan (LTIP) has been replaced moving forward by the LEA, however transitional arrangements mean that legacy LTIP awards will be paid in respect of 2019 and 2020.

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.

Variable Pay awards for 2020

Rewarding Excellence Award

The Rewarding Excellence Award (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% for each measure, making a total maximum award of 12% of individual's basic salary. In 2020, performance against the pre-set targets would have generated an award of 2.3%. However, the Remuneration Committee chose to exercise its discretion to increase this award to 3% in recognition of the extraordinary lengths colleagues have gone to throughout the pandemic to keep the Society safe and to deliver service to Members in the toughest of circumstances.

Leading Excellence Award

The Leading Excellence Award (LEA) was introduced in 2019 to replace the previous Long-Term Incentive Plan (LTIP). It is an annual incentive scheme with an element of deferred payment for Executives and Senior Leaders, designed to make setting meaningful targets more effective and therefore enabling the Society to reward, attract and retain our most senior leaders.

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 Personal Performance.

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.

Financial Performance

Return on Assets

Target: 0.220%
Achieved: 0.180%

Customer Service

Net Promoter Score (Ipsos Mori)

Target: Top 25%ile
Achieved: Top 10%ile

Maximum award:

38% for Executives
18% for Senior Leaders

Colleague Engagement

Great Place to Work Trust Index

Target: 75%
Achieved: 85%

Shared Strategic Business Objective

(delivery of Hybrid Technology Programme outcomes)

Although the Financial Performance measure was not met, the Remuneration Committee chose to exercise its discretion to make an 'on target' award of 19% for Executives and 9% for Senior Leaders to recognise their immense efforts during a very difficult year to deliver good results under the other three areas. 60% of the award is payable in March 2021, with the remaining 40% deferred as follows:

Senior Leaders

2019	2020	2021	2022	2023
Scheme year	60% award payment	40% award payment		
	Scheme year	60% award payment	40% award payment	
		Scheme year	60% award payment	40% award payment

Executives

2019	2020	2021	2022	2023	2024
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

Long-Term Incentive Plan (LTIP)

The Leading Excellence Award (LEA) replaced the Long-Term Incentive Plan (LTIP) in 2019 following a full review undertaken by the Remuneration Committee during 2018. There has been a transition period while the two schemes overlapped that ends this year. The table below illustrates how the 2018 LTIP ended on 31 December 2020, marking the final payment of this plan.

2018	2019	2020	2021	2022	2023	2024
2018 LTIP	2018 LTIP	2018 LTIP	Payment in 2021			
	2019 LEA	60% payment in 2020	20% – Executives 40% – Senior Leaders	20% Executives		
		2020 LEA	60% payment in 2021	20% Executives 40% Senior Leaders	20% Executives	
			2021 LEA	60% payment in 2022	20% Executives 40% Senior Leaders	20% Executives

The award made under the 2018 LTIP, to be paid in 2021 as shown below, is based upon the results of the challenging targets set by the Board back in 2018 for two key measures: a financial measure and a customer measure. The award of 14% was based on the following performance against targets:

Measure	Proportion of award	Targets			Result	Award level
		Threshold	On Target	Stretch		
Return on Assets	50%	0.301%	0.317%	0.333%	0.180%	0%
Net Promoter Score	50%	60th %ile	Top 25th %ile	Top 10th %ile	Top 10th %ile (6th of 56)	14%
Total Award						14%

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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 2020
- What the Executive Directors earned for 2020's performance compared to 2019
- CEO pay ratio
- Chair and Non-Executive Director fees in 2020

Salary increases applied to Executive Directors in 2020

In February 2020, the Remuneration Committee awarded a performance-related increase to the basic salary of the then Chief Customer Officer, the Chief Financial Officer and the Chief Operations Officer of 1.85%. The Chief Financial Officer and Chief Operations Officer also received a market-level adjustment to bring their basic salary closer to the external market median, in line with those in the workforce in similar positions in their pay grade's salary band, meaning their overall basic salary increases were 2.36% and 2.00%, respectively.

The Interim Chief Executive Officer and the Interim Chief Risk Officer did not receive basic salary increases in February 2020, per the terms of their interim arrangements. In recognition of the Interim Chief Executive Officer's stewardship of the Society during an unprecedentedly turbulent period, a 4.9% increase was applied retrospectively to the basic salary he received during his interim service. The Interim Chief Executive Officer and Interim Chief Risk Officer received a 1.85% increase to their substantive basic salaries when they returned to their substantive posts in September 2020.

In September 2020, when the new Chief Executive Officer was appointed, her basic salary was set at £350,000. This is in comparison to the previous Chief Executive Officer's salary of £355,000. As detailed later in this report, the new Chief Executive will no longer receive the car allowance she was previously eligible for and her employer pension contributions have been aligned with those of the rest of the workforce.

What Executive Directors earned for 2020's performance

The following table provides the audited information showing a single total figure of remuneration for the 2020 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]	2020	268	10	32	94	404
	2019	229	12	34	119	394
Interim Chief Executive Officer/ Chief Risk Officer[6] R Michael Jones	2020	307	13	46	n/a	366
	2019	258	13	39	n/a	310
Chief Financial Officer Tom Denman	2020	224	12	34	78	348
	2019	205	12	31	107	355
Chief Operating Officer Iain Mansfield[7]	2020	204	12	31	72	319
	2019	–	–	–	–	–
Former Chief Executive Officer Steve Hughes[8]	2020	–	–	–	–	–
	2019	305	14	46	–	365

[1] The review date for salary is 1 February 2021.
[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, plus payment from the 2018 Long-Term Incentive Plan (LTIP) as part of the transitional arrangements. The normal performance period of the LTIP is 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 became Chief Executive Officer on 14 September 2020. On the same date, R Michael Jones returned to his role as Chief Risk Officer.
[7] Iain Mansfield was appointed to the Board on 31 December 2019.
[8] Following his resignation as Executive Director on 2 December 2019, figures reflect payment up to and including 2 December 2019.

CEO Pay ratio

From 1 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 is 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 12 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
2020	Option A	18:1	12:1	9:1

The CEO base pay and total remuneration has been calculated to reflect the change in CEO during the financial year and includes the proportion of time that Julie-Ann Haines and R Michael Jones each spent in the role throughout 2020. A nominal version of the pay ratio that reflects the position at the end of 2020 is below:

Year	Method	25th percentile	Median	75th percentile
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.

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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 2020

Non-Executive Directors are paid a basic fee for participation on the Society Board and additional fees payable for providing services on Board Committees and/or for their membership of subsidiary company Boards. The fees paid to the Non-Executive Directors are set at a level which allows the Society to attract and retain the required calibre of Independent Directors. Fees paid to the Chair and the Non-Executive Directors were as follows:

Audited information Non-Executive Directors	Fees	
	2020 £000	2019 £000
Laurence Philip Adams	121	119
Nigel Annett CBE (Chair of Technology Committee)	63	63
Derek Howell (Chair of Audit Committee and Senior Independent Director)	72	71
Sally Jones-Evans (Chair of Remuneration Committee)	63	63
David Rigney (Chair of Board Risk Committee)	69	68
Claire Hafner	56	53
Debra Evans-Williams[1]	49	15
Total	**493**	**452**

[1] Debra Evans-Williams joined the Board on 3 September 2019

Looking ahead to 2021

Base salary

The Committee undertake a review of the Executive Directors' base salaries on 1 February of each financial year, taking into account factors such as individual and business performance, market conditions, and the level of salary increase applied to other colleagues across the Society. For 2021, it was agreed as part of the pay settlement negotiations that Executive Directors 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.

Following this review, the Executive Directors salaries will be:

- Julie-Ann Haines £350,000
- R Michael Jones £258,637
- Tom Denman £225,000
- Iain Mansfield £205,742

As Executives and SLT members will not be receiving a standard base pay increase for 2021, it was further agreed that Non-Executive Director fees would also not be increased, although market benchmarking will be undertaken as individuals move into new roles.

Benefits

In June 2020, the Remuneration Committee decided to withdraw the provision of car allowances for new appointments to roles at grade 14 and above, which includes all Executive Directors. Incumbents in these roles will retain their car allowance benefits while continuing to serve in those roles, but will have the allowance withdrawn on appointment to a different grade 14 or above role. When Julie-Ann Haines commenced her appointment as Chief Executive Officer in September 2020, her car allowance benefit was withdrawn.

No other changes have been made to the benefits in kind provided to Executive Directors.

Pension

Existing Executive Directors receive a pension contribution of 15% of base salary, which may be taken as a cash allowance, and this provision remains unchanged as it forms part of the contractual entitlements already in place. However, any newly appointed Executives or Executive Directors will be entitled to receive a pension contribution that is in line with that of the workforce, currently 8% of base salary, to align with the intent of the Corporate Governance Code. An exception to this was made on Iain Mansfield's appointment as Executive Director, as the appointment did not initiate an adjustment to any aspect of remuneration. When Julie-Ann Haines commenced her appointment as Chief Executive Officer in September 2020, her employer pension contribution was aligned to the workforce rate of 8%.

Variable pay

Both the REA and the LEA will continue to operate from 1 January 2021. A summary is set out below:

	Rewarding Excellence Award	Leading Excellence Award
Performance period	1 January 2021 to 31 December 2021	1 January 2021 to 31 December 2021
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	Capital and liquidity conditions and the absence of any material regulatory breaches
Performance measures	Group Profit before Tax – 50% Customer Service NPS – 50%	Return on Assets – 25% NPS – 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

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	Rewarding Excellence Award	Leading Excellence Award
Payment date	Subject to Audit and Remuneration Committee approval, payment will be made in March 2022 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 2022 Following this, Executives will receive a deferred payment of 20% in March 2023 and a final deferred payment of 20% in March 2024 Senior Leaders will receive a final deferred payment of 40% in March 2023
Clawback (demanding repayment)	The Remuneration Committee can apply clawback to an Executive Director's award, and that of other Senior Leaders 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 2019 Director's Remuneration Report received 18,109 votes in favour (90.84%) and 1,875 votes against (9.16%).

Approval

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

Sally Jones-Evans
Chair of the Remuneration Committee
16 February 2021

Directors' report

for the year ended 31 December 2020

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 2020. 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 group's performance, business model and strategy. Further information is provided in the Report of the Audit Committee.

Directors

The names of the Directors at the date of this report, together with brief biographical details, are listed on pages 52 to 56. Details of changes affecting the composition of the Board are set out in the Governance Report on pages 57 to 67. 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 the Chair, Laurence Adams, who will retire from the Board following the 2021 AGM, 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 29 April 2020, 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 104 to 105, is made by the Directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Remuneration Committee Report, 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 Director's are responsible for ensuring that the Society and its subsidiary undertakings:

- keeps accounting records in accordance with the Building Societies Act 1986; and
- takes 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 52 to 56, 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 www.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 group. This information is contained principally in the Strategic Report. The directors confirm that, to the best of each of their knowledge and belief:

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

Long-term viability statement and going concern

The Directors have assessed the viability of the group over a three-year period taking into account the business strategy, current economic conditions and the principal, emerging and evolving risks set out in the Risk Overview in the Strategic Report, which include consideration of the impacts from the COVID-19 pandemic. The latter includes:

- Operational changes resulting from the majority of head office colleagues now working from home.
- Liquidity impacts from mortgage payment holidays and other forms of support for Commercial customers.
- Outlook for the mortgage and savings markets in the UK and impacts on growth aspirations.
- Financial and capital impacts from the increased risk of loan losses which may arise if borrowers fall into arrears as a result of the economic impacts of the pandemic.

Having taken these factors into account, the Directors have a reasonable expectation that the business 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 group, 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 group'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 group's lending portfolios and the availability of retail deposits and wholesale funding. The plan is stress tested through the group'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 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.

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 group, the Directors are satisfied that there are 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.

Strategic Report

The group's strategic report information required by Schedule 7 to the Accounting Regulations and the capital structure of the group are set out in the Strategic Report on pages 4 to 49.

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 which came into force in July 2011. 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.

Employees

The group remains committed to its policy of treating all employees and job applicants equally at all times. Our policy is that no employee, or potential employee, is treated less favourably on the grounds of age, race, colour, religion, nationality, ethnic origin, gender, marital status or sexual orientation. We also give all applications from disabled people full consideration in relation to the vacancy concerned and their own aptitudes and abilities.

In the event of an existing employee becoming disabled, we make every effort to maintain their present position or to employ them in alternative suitable work. We also aim to provide high quality relevant training and development opportunities to all employees, which enables them to achieve their full potential.

The Board receives regular updates on key employee matters as they arise. There is a comprehensive internal communications structure to cascade relevant business information to colleagues throughout the organisation in an appropriate and timely way.

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 group can be found in the Strategic Report and in note 20. All group companies operate in the United Kingdom only.

b) Average number of employees

The average number of employees is disclosed in note 8.

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 2020 (2019: none).

Charitable and political donations

In 2020, the Society made donations to charities of £0.2m (2019: £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 4 days at 31 December 2020 (2019: 3 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 2020 meeting alongside receiving the annual Board Whistleblowing Champions Report.

On behalf of the Board of Directors.

C. P. Adams

Laurence Philip Adams
Chair
16 February 2021

Financial statements

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

Report on the audit of the financial statements

Opinion

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

- **give a true and fair view of the state of the group's and of the Society's affairs as at 31 December 2020 and of the group's and the Society's income and expenditure for the year then ended;**
- **have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and**
- **have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the group financial statements, Article 4 of the IAS Regulation.**

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 statements of movements in Members' interests;
- the group and Society cash flow statements; and
- the related notes 1 to 34.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

Basis for opinion

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

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

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

Summary of our audit approach

Key audit matters	The key audit matter that we identified in the current year was: • IFRS 9 Financial Instruments – Expected Credit Loss ("ECL") provisioning. Within this report, key audit matters are identified as follows: 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 £2.0m which was determined on the basis of 0.3% 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 5% of profit before tax in the prior year, to 0.3% of net assets in the current year. The rationale is explained on page 103. 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 and society's ability to continue to adopt the going concern basis of accounting included:

- We have reviewed and challenged the directors' statement on page 94 about whether they consider it appropriate to adopt the going concern basis of accounting;
- With the involvement of prudential regulation specialists, we have reviewed and challenged the group and society's compliance with regulation including capital and liquidity requirements;
- We have assessed and challenged the appropriateness of the assumptions used in forecasts prepared by management, through comparison to independent macroeconomic scenarios; 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 mortgages; and • Secured personal lending. The group held £34.3m (2019: £25.6m) of ECL provisions against total loans and advances to customers of £9,142.7m (2019: £9,469.9m). 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 the 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 collective provisioning methodologies to be: • Updated Probability of Default ('PD') and Significant Increase in Credit Risk ('SICR') methodology: The PD and SICR methodology for residential and second charge mortgage portfolios has been revised in the year. Changes made to the model are considered by management to be a complex area of statistical modelling and a significant level of management judgement is involved in developing the models. • Commercial Probability of Default rates: The PD rates applied within the model are supported by the historic performance of the loanbook. The current economic developments and outlook are significantly different to the previous recessions and the Commercial profile has changed in the years since the last recession. This increases the risk that the rates applied are no longer appropriate in light of the current data.

Key audit matter description	• Sufficient incorporation of the forward-looking economic factors within the Commercial staging assessment: Commercial staging is calculated using risk gradings applied to individual exposures. By design the risk grading process does not fully consider the effect of changes in macro-economic forecasts. Management address the limited forward-looking consideration through post model adjustments. In the current economic environment, it is important that the staging consideration incorporates a sufficient level of forward-looking considerations such as future tenancy demand. • Macroeconomic scenarios, including consideration for Covid-19, the UK's exit from the European Union and associated weighting applied: ECLs are required to be calculated on a forward-looking basis under IFRS 9. In determining both the economic scenarios, as well as the probability-weighting of each scenario to be incorporated into the ECL model, significant judgement is applied by management. Other material judgements include the estimation of probability of default, loss given default, exposure at default and the post model adjustments applied to the model. The significant increase in credit risk definition in the Commercial model remains a material judgement that has been consistently applied since the prior period. 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 to defer profits or conceal problems with credit quality. The group's loan loss provision balances are detailed within note 18. Management's associated accounting policies are detailed on pages 118-120 with detail about judgements in applying accounting policies and critical accounting estimates on page 126. Management's consideration of the effect of the future economic environment is disclosed on page 150-151. The Audit Committees' consideration of the matter is described on page 75.
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 inputs** • With involvement of our internal credit risk modelling specialists, we challenged whether the updated methodology meets the requirements of IFRS 9. We have also performed procedures to confirm that the methodology changes have been reflected in the models through review and challenge of the underlying code. We have tested the completeness and accuracy of the data that support management's conclusions regarding the appropriateness of the methodology changes.

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How the scope of our audit responded to the key audit matter

- We challenged the appropriateness of Commercial PD rates by assessing the performance of the model against historic default experience. We have also assessed the forecasted default experience and its sensitivity to individual defaults. In doing so, we have challenged management's assumptions regarding the relationship between the upcoming recession and the historic recession experience.
- We performed a detailed review of the Commercial risk grading process with particular reference to the forward-looking requirements of IFRS 9. We have then assessed the consistency of the application of the methodology in reviews performed in the year.
- 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 UK's exit from the European Union 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 expected impact of the COVID-19 pandemic and the UK's exit from the European Union.
- We assessed whether the post model adjustments identified by management had adequately addressed modelling limitations and been completely and accurately calculated.

Assessment of the ECL model

- With the involvement of credit modelling specialists, we reviewed the models 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 considered whether changes had been made to management's models. Where changes had not been made, we confirmed this by comparison to prior year 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 completeness and accuracy of the data provided by management that supported each material judgement against internal and external supporting information.
- We assessed the appropriateness of the data used in the model in light of the developments in the current environment.

Key observations

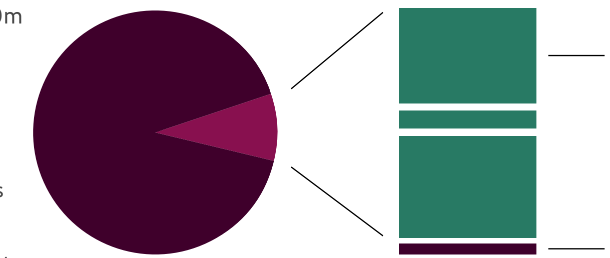
Based on our audit procedures above, we concluded that management's provision is reasonably stated, and is supported by a methodology that is appropriately applied. However we note the provision levels are less conservative than in the prior year primarily driven by the society's macro-economic outlook which has moved closer to consensus compared to 2019 when management took a negative view on the likely outcome of negotiations relating to the UK's exit from the European Union.

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	£2.0m (2019: £2.0m)	£1.3m (2019: £1.3m)
Basis for determining materiality	0.3% of net assets (2019: 5% profit before tax)	0.3% of net assets (2019: 5% profit before tax)
Rationale for the benchmark applied	The key reason for the change in benchmarks used are that the overall capital base is a key focus area for the group and Society's Members and regulators and that the industry is experiencing lower margins at the same time as net assets of the group and Society are growing. Therefore, net assets has been considered a more appropriate base on which to determine materiality. Due to the impact of Covid-19 on the group and Society's financial statements it has been considered appropriate to cap materiality at 2019 levels despite the change in benchmark. This has been achieved by reducing the factor applied to the benchmark. 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% (2019: 70%) of group materiality	70% (2019: 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 £0.1m (2019: £0.1m), 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 audit engagement team. Our audit scoping provides full scope and coverage of 100% if the Group's revenue, profit before tax and net assets. There are 6 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 £1.4m (2019: 1.0m to £1.4m).

Our consideration of the control environment
A controls reliance strartegy over the the lending and savings cycles was planned and taken. We evaluated the design and implementation and tested the operating effectiveness of controls within these cycles. In order to test the operating effectiveness of each control, 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:
  - o identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - o detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - o 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, 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: 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 misspelling 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 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 96 to the financial statements for the financial year ended 31 December 2020 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by Country Reporting) Regulations 2013.

Corporate Governance Statement

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

- the directors' statement with regards the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on pages 94 to 95.

- the directors' explanation as to its assessment of the group's prospects, the period this assessment covers and why the period is appropriate set out on pages 94 to 95.
- the directors' statement on fair, balanced and understandable set out on page 93.
- the board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 94.
- the section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on page 76.
- the section describing the work of the Audit Committee set out on pages 74 to 79.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

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

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

We have nothing to report in respect of these matters.

Other matters

Audit tenure

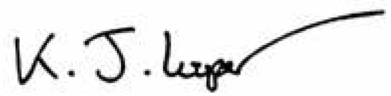
Following the recommendation of the Audit Committee, we were appointed at the Annual General meeting by the members of the Society on 27 April 2007 to audit the financial statements for the year ending 31 December 2007 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 14 years, covering the years ending 31 December 2007 to 31 December 2020.

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.



Kieren Cooper FCA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Cardiff, United Kingdom
16 February 2021

Consolidated income statement *for the year ended 31 December 2020*

	Notes	2020 £m	2019 £m
Interest receivable and similar income	4	205.6	233.9
Interest payable and similar charges	5	(97.0)	(122.5)
Net interest income		108.6	111.4
Fees and commission receivable	6	4.1	4.9
Fees and commission payable		(2.1)	(1.5)
Net fee and commission income		2.0	3.4
Other operating income		0.7	1.0
Other fair value losses	7	(4.1)	(0.2)
Net operating income		**107.2**	**115.6**
Administrative expenses	8	(70.9)	(72.8)
Depreciation and amortisation	21 & 22	(9.0)	(7.3)
Operating expenses		(79.9)	(80.1)
Impairment provision (charge)/release on loans and advances	18	(9.1)	4.1
Provision for liabilities	19	1.7	-
Operating profit and profit before taxation		**19.9**	**39.6**
Taxation expense	12	(4.0)	(7.6)
Profit for the year		**15.9**	**32.0**

Consolidated statement of other comprehensive income

	Notes	2020 £m	2019 £m
Profit for the year		15.9	32.0
Items that will not be reclassified subsequently to profit and loss:			
Actuarial (loss)/gain on retirement benefit obligations	11	(5.7)	0.3
Tax charge/(credit) on retirement benefit obligations	12	1.1	(0.1)
Items that may be reclassified subsequently to profit and loss:			
(Loss)/gain on fair value through other comprehensive income		(0.1)	0.6
Tax charge on fair value through other comprehensive income	12	-	(0.1)
Total comprehensive income for the year		**11.2**	**32.7**

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

The accounting policies and notes on pages 115 to 181 form part of these accounts.

Income statement of the Society *for the year ended 31 December 2020*

	Notes	2020 £m	2019 £m
Interest receivable and similar income	4	196.2	223.3
Interest payable and similar charges	5	(96.7)	(121.8)
Net interest income		99.5	101.5
Fees and commission receivable	6	4.1	4.9
Fees and commission payable		(2.1)	(1.5)
Net fee and commission income		2.0	3.4
Other operating income		0.7	1.3
Other fair value gains	7	5.5	0.7
Net operating income		**107.7**	**106.9**
Administrative expenses	8	(70.5)	(72.1)
Depreciation and amortisation	21 & 22	(9.0)	(7.1)
Operating expenses		(79.5)	(79.2)
Impairment provision (charge)/release on loans and advances	18	(9.7)	0.5
Provision for liabilities	19	0.5	-
Operating profit and profit before taxation		**19.0**	**28.2**
Taxation expense	12	(1.8)	(5.4)
Profit for the year		**17.2**	**22.8**

Statement of other comprehensive income of the Society

	Notes	2020 £m	2019 £m
Profit for the year		17.2	22.8
Items that will not be reclassified subsequently to profit and loss:			
Actuarial (loss)/gain on retirement benefit obligations	11	(5.7)	0.3
Tax charge/(credit) on retirement benefit obligations	12	1.1	(0.1)
Items that may be reclassified subsequently to profit and loss:			
(Loss)/gain on fair value through other comprehensive income		(0.1)	0.6
Tax charge on fair value through other comprehensive income	12	-	(0.1)
Total comprehensive income for the year		**12.5**	**23.5**

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 115 to 181 form part of these accounts.

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Consolidated statement of financial position *as at 31 December 2020*

	Notes	2020 £m	2019 £m
Assets			
Liquid assets:			
Cash in hand and balances with the Bank of England		1,438.5	1,201.9
Loans and advances to credit institutions	13	290.7	202.6
Debt securities	14	78.7	165.1
		1,807.9	1,569.6
Derivative financial instruments	15	23.7	21.3
Loans and advances to customers:			
Loans fully secured on residential property		8,897.7	8,721.7
Other loans		307.2	311.4
	16	9,204.9	9,033.1
Intangible fixed assets	21	25.4	17.5
Property, plant and equipment	22	36.5	34.8
Investment properties	22	6.5	6.9
Deferred tax assets	27	2.3	1.8
Other assets		4.4	3.9
Prepayments and accrued income		9.3	6.9
Total assets		**11,120.9**	**10,695.8**
Liabilities			
Shares	23	8,187.4	7,588.5
Deposits and debt securities:			
Amounts owed to credit institutions	24	1,026.2	1,072.5
Amounts owed to other customers		201.3	197.9
Debt securities in issue	25	972.6	1,107.7
		2,200.1	2,378.1
Derivative financial instruments	15	106.2	50.4
Current tax liabilities		1.1	2.8
Other liabilities	26	17.1	14.0
Provision for liabilities	19	2.8	4.4
Accruals and deferred income		7.2	11.8
Deferred tax liabilities	28	1.7	1.2
Retirement benefit obligations	11	2.7	-
Subscribed capital	27	-	61.2
Total liabilities		10,526.3	10,112.4
General reserve		593.4	582.1
Other reserves		1.2	1.3
Total equity and liabilities		**11,120.9**	**10,695.8**

The accounting policies and notes on pages 115 to 181 form part of these accounts. These accounts were approved by the Board and authorised for issue on 16 February 2021:

Laurence Philip Adams	Julie-Ann Haines	Tom Denman
Chair	**Chief Executive Officer**	**Chief Financial Officer**

Statement of financial position of the Society *as at 31 December 2020*

	Notes	2020 £m	2019 £m
Assets			
Liquid assets:			
Cash in hand and balances with the Bank of England		1,438.5	1,201.9
Loans and advances to credit institutions	13	199.3	107.8
Debt securities	14	78.7	165.1
		1,716.5	1,474.8
Derivative financial instruments	15	23.6	16.5
Loans and advances to customers:			
Loans fully secured on residential property		8,756.6	8,542.3
Other loans		307.2	311.4
	16	9,063.8	8,853.7
Investments in subsidiary undertakings	20	24.0	68.6
Intangible fixed assets	21	25.4	17.5
Property, plant and equipment	22	35.9	34.2
Investment properties	22	6.5	6.9
Deferred tax assets	27	2.2	1.7
Other assets		4.4	2.5
Prepayments and accrued income		9.3	6.7
Total assets		**10,911.6**	**10,483.1**
Liabilities			
Shares	23	8,187.4	7,588.5
Deposits and debt securities:			
Amounts owed to credit institutions	24	1,601.3	1,783.3
Amounts owed to other customers		201.3	197.9
Debt securities in issue	25	307.0	301.5
		2,109.6	2,282.7
Derivative financial instruments	15	97.2	47.7
Current tax liabilities		-	1.7
Other liabilities	26	17.1	12.3
Provision for liabilities	19	1.3	1.7
Accruals and deferred income		6.8	10.8
Deferred tax liabilities	27	1.5	1.0
Retirement benefit obligations	11	2.7	-
Subscribed capital	29	-	61.2
Total liabilities		10,423.6	10,007.6
General reserve		486.8	474.2
Other reserves		1.2	1.3
Total equity and liabilities		**10,911.6**	**10,483.1**

The accounting policies and notes on pages 115 to 181 form part of these accounts. These accounts were approved by the Board and authorised for issue on 16 February 2021:

Laurence Philip Adams	Julie-Ann Haines	Tom Denman
Chair	**Chief Executive Officer**	**Chief Financial Officer**

Statement of changes in Members' interests *for the year ended 31 December 2020*

	2020			2019		
	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	582.1	1.3	583.4	550.1	0.6	550.7
Comprehensive income for the year	11.3	(0.1)	11.2	32.0	0.7	32.7
At 31 December	**593.4**	**1.2**	**594.6**	**582.1**	**1.3**	**583.4**
Society				-	-	-
At 1 January	474.2	1.3	475.5	451.4	0.6	452.0
Comprehensive income for the year	12.6	(0.1)	12.5	22.8	0.7	23.5
At 31 December	**486.8**	**1.2**	**488.0**	**474.2**	**1.3**	**475.5**

The group's capital at 31 December 2020 comprises the general reserve adjusted in line with regulatory rules. In 2019 capital also included the group's subscribed capital (Permanent Interest-Bearing Shares or PIBS). The PIBS were redeemed in full on 1 June 2020. The group complied with all regulatory capital requirements throughout the current and prior year.

Consolidated statement of cash flows *for the year ended 31 December 2020*

	2020 £m	2019 £m
Net cash flows from operating activities (see below)	443.8	406.8
Cash flows from investing activities		
Purchase of intangible assets	(9.7)	(13.0)
Purchase of property, plant and equipment	(6.5)	(7.6)
Purchase of investment securities	(53.4)	(200.3)
Proceeds from sale and maturity of investment securities	139.9	68.9
Net cash flows from investing activities	**70.2**	**(152.0)**
Cash flows from financing activities		
Interest paid on subscribed capital	(1.7)	(4.2)
Interest paid on debt securities in issue	(15.7)	(23.3)
Proceeds from issuance of debt securities in issue	28.9	431.7
Redemption of debt securities in issue	(139.7)	(332.4)
Repayment of lease liabilities	(1.2)	(1.7)
Repayment of subscribed capital	(60.0)	-
Net cash flows from financing activities	**(189.4)**	**70.1**
Increase in cash and cash equivalents	324.7	324.9
Cash and cash equivalents at the beginning of year	1,404.5	1,079.6
Cash and cash equivalents at the end of year	**1,729.2**	**1,404.5**
Represented by:		
Cash and balances with the Bank of England	1,438.5	1,201.9
Loans and advances to credit institutions repayable on demand	290.7	202.6
	1,729.2	**1,404.5**
Cash flows from operating activities	1,729.2	1,404.5
Profit before taxation	19.9	39.6
Adjusted for:		
Depreciation and amortisation	9.0	7.3
Charge on defined benefit scheme	0.1	0.1
Impairment on loans and advances to customers	9.1	(4.1)
Change in fair values	(40.0)	(28.0)
Release of other provisions	(1.7)	-
Interest on debt securities in issue	14.6	24.5
Interest on subscribed capital	1.7	4.2
Non-cash items included in profit before tax	0.8	0.2
Changes in net operating assets		
Loans and advances to customers	(134.1)	(505.6)
Other operating assets	(3.0)	(2.2)
Derivative financial instruments	53.4	22.3
Shares	596.1	595.9
Deposits	(71.8)	261.9
Other operating liabilities	(2.5)	0.2
Contributions paid into defined benefit scheme	(3.1)	(3.7)
Taxation paid	(4.7)	(5.8)
Net cash flows from operating activities	**443.8**	**406.8**

The group is required to maintain interest-free balances with the Bank of England which at 31 December 2020 amounted to £30.9m (2019: £26.3m).

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Statement of cash flows of the Society *for the year ended 31 December 2020*

	2020 £m	2019 £m
Net cash flows from operating activities (see below)	327.6	474.8
Cash flows from investing activities		
Purchase of intangible assets	(9.7)	(13.0)
Purchase of property, plant and equipment	(6.5)	(7.6)
Purchase of investment securities	(53.4)	(200.3)
Proceeds from sale and maturity of investment securities	139.9	68.9
Net cash flows from investing activities	**70.3**	**(152.0)**
Cash flows from financing activities		
Interest paid on subscribed capital	(1.7)	(4.2)
Interest paid on debt securities in issue	(7.1)	(7.0)
Repayment of lease liabilities	(1.0)	(1.3)
Repayment of subscribed capital	(60.0)	-
Net cash flows from financing activities	**(69.8)**	**(12.5)**
Increase in cash and cash equivalents	328.1	310.3
Cash and cash equivalents at the beginning of year	1,309.7	999.4
Cash and cash equivalents at the end of year	**1,637.8**	**1,309.7**
Represented by:		
Cash and balances with the Bank of England	1,438.5	1,201.9
Loans and advances to credit institutions repayable on demand	199.3	107.8
	1,637.8	**1,309.7**
Cash flows from operating activities		
Profit before taxation	19.0	28.2
Adjusted for:		
Depreciation and amortisation	9.0	7.1
Charge on defined benefit scheme	0.1	0.1
Impairment on loans and advances to customers	9.7	(0.5)
Change in fair values	(40.0)	(20.9)
Release of other provisions	(0.5)	-
Interest on debt securities in issue	7.1	7.1
Interest on subscribed capital	1.7	4.2
Non-cash items included in profit before tax	0.5	0.3
Changes in net operating assets		
Loans and advances to customers	(173.1)	(566.1)
Decrease in loans to subsidiary companies	44.6	66.7
Other operating assets	(4.6)	(0.9)
Derivative financial instruments	42.4	21.1
Shares	596.1	595.9
Deposits	(178.6)	339.9
Other operating liabilities	(0.2)	(0.3)
Contributions paid into defined benefit scheme	(3.1)	(3.7)
Taxation paid	(2.5)	(3.4)
Net cash flows generated from operating activities	**327.6**	**474.8**

Notes to the accounts *for the year ended 31 December 2019*

1. Accounting policies

Basis of preparation

These financial statements for the year ended 31 December 2020 have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee as adopted by the European Union (EU), and those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to Societies reporting under IFRS.

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

There were no new standards adopted in the current year. In the prior year, the group early adopted the amendments to IFRS 9, IAS 39 and IFRS 7: Interest Rate Benchmark Reform - Phase 1, which had an effective date of 1 January 2020. The amendments modify specific hedge accounting requirements to allow hedge accounting to continue for affected hedges during the period of uncertainty before impacted hedged items and hedging instruments are amended as a result of the on-going interest rate benchmark reforms.

The amendments are relevant to the group as it hedges and applies hedge accounting to its benchmark interest rate exposure. The application of the amendments impact the group's accounting in the following ways:

- The group has loan advances to Commercial lending customers, linked to GBP LIBOR. The interest rate risk of these advances is hedged using GBP LIBOR interest rate swaps. A portion of the advances and associated swaps are included in a portfolio fair value hedge, with the remainder included in micro hedge relationships.
- The amendments permit continuation of hedge accounting even though there is uncertainty about the timing and amount of the hedged cash flows due to the interest rate benchmark reforms.
- The group will not discontinue hedge accounting should the assessment of hedge effectiveness fall outside the 80%-125% range and the hedging relationship is subject to interest rate benchmark reforms. For those hedging relationships that are not subject to the interest rate benchmark reforms, the group will continue to cease hedge accounting if effectiveness is outside the 80%-125% range.

The adoption of these amendments allows the group to continue hedge accounting during the period of uncertainty arising from interest rate benchmark reforms.

Adoption of other amendments to existing standards and annual improvements applicable in 2020 did not have any impact on the group's accounting policies and did not require retrospective adjustments.

1. Accounting policies (continued)

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. Of these, only the amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16: Interest Rate Benchmark Reform - Phase 2, is expected to have significant impact for the group. The amendments have a mandatory effective date of 1 January 2021, with early adoption permitted.

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.

At 31 December 2020, the group has 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. Further disclosure is provided in note 15.

The process to transition the GBP LIBOR linked loans and associated swaps to a new benchmark rate is scheduled to take place during 2021 and the group expects to make use of the accounting reliefs available, subject to the relevant criteria being met.

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.

1. Accounting policies (continued)

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, debt securities in issue and, until June 2020, Permanent Interest Bearing Shares (subscribed capital).

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.

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1. Accounting policies (continued)

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.

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

1. Accounting policies (continued)

iii) Hedge accounting (continued)

interest rate swap or forward contract with no unusual terms and a zero fair value at inception of the hedge relationship). The fair value of the hypothetical derivative is then used as a proxy for the net present value of the hedged future cash flows against which changes in value of the actual hedging instrument are compared to assess effectiveness and measure ineffectiveness.

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

Portfolio (macro) fair value hedges

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

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

Micro fair value hedges

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

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

The group discontinues hedge accounting when:

i) it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge;
ii) the derivative expires, or is sold, terminated or exercised; or
iii) the underlying item matures or is sold or repaid.

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.

1. Accounting policies (continued)

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

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

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

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

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

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

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

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

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

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

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.

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

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 119, 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. During the year refinements were made to the PD model to more closely align the relationship between lifetime PD and the forward looking macro-economic scenarios. As a result of this change a 10% absolute threshold was introduced to prevent high volumes of low risk accounts in the retail portfolio with 12 month PDs below 0.4% migrating to stage 2.

Sensitivity analysis has been performed on the staging criteria. A 10% variance has been selected as this is deemed to be the maximum variation likely to occur over a 12 month period in the current economic environment. The impact of 10% of the loans currently in stage 1 moving to stage 2 and assigned an average 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	7.9	0.7	3.0
Stage 2 to stage 1	(0.5)	(0.1)	(0.4)

Post model adjustment - mortgage payment deferrals

As at 31 December 2020 there were approximately 1,000 customers subject to a COVID-19 related mortgage payment holiday. All of these customers have been treated as having experienced a significant increase in credit risk and any accounts that would otherwise have been classified within stage 1 have been moved to stage 2. The outcome of payment holiday behaviour is still unclear therefore a post model adjustment of £2.7m (2019: £nil) has been provided to address the risk that a proportion of these customers would otherwise, or may still, go into arrears and eventually to default. For every additional 100 customers that progress to arrears (over and above that already assumed in determining the overlay) the ECLs would increase by a further £0.4m.

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.

Customer complaints

The group holds provisions for customer complaints, primarily in relation to past sales of secured personal lending products. Estimations are involved in determining the level of provision to hold for such complaints. The level of provision is calculated based upon the estimates of complaint volumes, the rate at which these claims are upheld and the level of redress paid on each complaint. Further information is included in note 19.

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.

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

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3. Business segments (continued)

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

	Group	
	2020 £m	2019 £m
Total assets by business segments		
Retail financial services	10,141.0	9,665.9
Commercial lending	838.7	850.3
Secured personal lending	141.2	179.6
Total assets	**11,120.9**	**10,695.8**
Total liabilities & equity by business segment		
Retail financial services & commercial lending	10,979.7	10,516.2
Secured personal lending	141.2	179.6
Total liabilities & equity	**11,120.9**	**10,695.8**

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	
	2020 £m	2019 £m	2020 £m	2019 £m
On loans fully secured on residential property	219.2	221.3	206.7	205.1
On other loans	11.5	11.9	11.5	11.9
On loans to subsidiaries	-	-	3.5	5.7
On debt securities	1.1	1.2	1.1	1.2
On other liquid assets	2.9	7.7	2.5	7.6
On derivative financial instruments	(29.1)	(8.2)	(29.1)	(8.2)
	205.6	**233.9**	**196.2**	**223.3**

5. Interest payable and similar charges

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
On shares held by individuals	81.8	92.8	81.8	92.8
On deposits and debt securities	21.0	28.8	24.2	26.9
On subscribed capital	1.7	4.2	1.7	4.2
On lease liabilities	0.2	0.3	0.2	0.2
On derivative financial instruments	(7.7)	(3.6)	(11.2)	(2.3)
	97.0	**122.5**	**96.7**	**121.8**

6. Fees and commission receivable

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Insurance & related financial service products	1.1	1.3	1.1	1.3
Mortgage related fees	3.0	3.5	3.0	3.5
Other fees and commission	-	0.1	-	0.1
	4.1	**4.9**	**4.1**	**4.9**

7. Other fair value gains and losses

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Losses on derivatives in hedging relationships	(41.3)	(23.0)	(41.3)	(23.0)
(Losses)/gains on derivatives not in hedging relationships	(2.8)	1.9	6.8	2.8
Losses on derivatives	**(44.1)**	**(21.1)**	**(34.5)**	**(20.2)**
Gains on economic hedged items	7.2	5.9	7.2	5.9
Gains on hedged items attributable to the hedged risk	32.8	15.0	32.8	15.0
Gains on hedged items	**40.0**	**20.9**	**40.0**	**20.9**
	(4.1)	**(0.2)**	**5.5**	**0.7**

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	
	2020 £m	2019 £m	2020 £m	2019 £m
Wages and salaries	35.8	37.2	35.8	37.2
Social security costs	3.8	4.0	3.8	4.0
Other pension costs	2.4	2.2	2.4	2.2
	42.0	**43.4**	**42.0**	**43.4**
Other administrative expenses	28.9	29.4	28.5	28.7
	70.9	**72.8**	**70.5**	**72.1**

	Group		Society	
	2020 £000	2019 £000	2020 £000	2019 £000
Other administrative expenses include:				
Auditor's remuneration				
For audit of the Society's Annual Accounts	384	270	384	270
For audit of the Society's subsidiaries	96	65	-	-
Total	480	335	384	270
For other services				
Further assurance services	66	79	66	79
Total other services	66	79	66	79

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

9. Employees

The average number employed including Executive Directors was:

	Full-time		Part-time	
	2020 Number	2019 Number	2020 Number	2019 Number
Society's Customer Support Centre and administration office	691	671	99	119
Society branches	206	205	114	126
Employed by the group	**897**	**876**	**213**	**245**

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 to the Building Societies (Accounts and Related Provisions) Regulations 1998. Total Directors' emoluments for the year were £1.9m (2019: £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 1 January 2001 and those staff who were formerly members of the defined benefit scheme are eligible to join this scheme. The cost to the group and Society of employer's contributions (before salary sacrifice arrangements) to the scheme in 2020 was £2.4m (2019: £2.2m). There were no contributions outstanding or prepaid at the end of the year.

Defined benefit scheme

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

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

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

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

During the year £3.1m was paid into the pension scheme from the Society (2019: £3.7m). The agreed contributions to be paid by the Society in 2021 amount to £1.7m. 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

11. Retirement benefit obligations (continued)

Defined benefit scheme (continued)

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

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

The cumulative amount of actuarial losses recognised in other comprehensive income since the date of transition to IFRS is £37.1m (2019: £31.4m).

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

	At 31 December				
	2020 %	2019 %	2018 %	2017 %	2016 %
Rate of increase of pensions in payment:					
CPI 3% Pre-2030	1.80	1.95	2.25	2.20	2.25
CPI 3% Post-2030	2.35	1.95	2.25	2.20	2.25
CPI 5% Pre-2030	2.00	2.15	-	-	-
CPI 5% Post-2030	2.80	2.15	-	-	-
Discount rate	1.30	2.00	2.80	2.40	2.55
Inflation assumption (RPI)	2.95	3.00	3.20	3.20	3.25
Inflation assumption (CPI):					
Pre-2030	1.95	2.15	2.20	2.20	2.25
Post-2030	2.85	2.15	2.20	2.20	2.25

The assumptions used for the valuation at 31 December 2020 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:

	2020	2019
Retired and non-retired members	S3NA CMI 2019 LTR 1.25%	S2NA CMI 2018 LTR 1.25%
The assumptions are illustrated by the following years of life expectancy at age 65:		
Retired members		
Males currently aged 65	22.2	22.1
Females currently aged 65	24.6	24.4
Non-retired members		
Males currently aged 45	23.5	23.4
Females currently aged 45	26.0	25.8

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

	At 31 December				
	2020 £m	2019 £m	2018 £m	2017 £m	2016 £m
Target return funds	-	-	-	29.0	27.4
Multi asset	40.2	36.5	29.0	-	-
LDI	11.7	8.5	6.7	-	-
Annuities	26.0	25.5	23.9	25.9	26.4
Bonds and cash	4.8	3.8	3.4	8.5	4.3
Total fair value of plan assets	**82.7**	**74.3**	**63.0**	**63.4**	**58.1**
Present value of funded obligations	(84.9)	(73.8)	(66.4)	(71.8)	(72.9)
Present value of unfunded obligations	(0.5)	(0.5)	(0.5)	(0.5)	(0.5)
Net deficit recognised in the statement of financial position	**(2.7)**	**-**	**(3.9)**	**(8.9)**	**(15.3)**

The deficit has increased over the course of 2020, primarily as a result of movements in the discount rate which impacts the scheme liabilities, but has been offset by the £3.1m of contributions paid into the pension scheme by the Society in 2020.

The actual gain on plan assets was £8.0m during the year (2019: £9.9m).

11. Retirement benefit obligations (continued)

Defined benefit scheme (continued)

The amounts recognised in the income statement are as follows:

	Group and Society	
	2020 £m	2019 £m
Analysis of the amounts recognised in the income statement		
Interest on pension scheme assets	(1.5)	(1.8)
Interest on pension scheme liabilities	1.5	1.9
Net interest expense	**-**	**0.1**
Past service cost	0.1	-
Total amount recognised in the income statement	**0.1**	**0.1**
Analysis of amount recognised in statement of other comprehensive income		
Gain on scheme assets in excess of interest	6.5	8.1
Experience gains on liabilities	1.1	0.8
Losses from changes to demographic assumptions	(0.4)	(0.4)
Losses from changes to financial assumptions	(12.9)	(8.2)
Total remeasurement	**(5.7)**	**0.3**
Analysis of the movement in the statement of financial position deficit		
Deficit in scheme at beginning of year	-	(3.9)
Movement in year:		
Net interest expense	-	(0.1)
Remeasurements	(5.7)	0.3
Contributions paid and accrued	3.1	3.7
Past service cost	(0.1)	-
Deficit in scheme at end of year	**(2.7)**	**-**
Analysis of the movement in the fair value of pension scheme assets		
Fair value of assets at the beginning of the year	74.3	63.0
Interest on assets	1.5	1.8
Society contributions	3.1	3.7
Benefits paid	(2.6)	(2.2)
Return on plan assets less interest	5.9	6.4
Change in fair value of the annuity policy	0.5	1.6
Fair value of assets at the end of the year	**82.7**	**74.3**
Analysis of the movement in the present value of the pension scheme liabilities		
Present value of liabilities at the beginning of the year	74.3	66.9
Interest expense	1.5	1.8
Remeasurement losses/(gains):		
Actuarial gains & losses arising from changes in demographic assumptions	0.4	0.4
Actuarial gains & losses arising from changes in financial assumptions	12.9	8.2
Actuarial gains & losses arising from experience adjustments	(1.1)	(0.8)
Benefits paid	(2.6)	(2.2)
Past service cost	-	-
Present value of liabilities at the end of the year	**85.4**	**74.3**

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	(7.3)	7.3
Inflation	7.2	(7.2)
Life expectancy (+1 year/-1 year)	3.6	(3.6)

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	
	2020 £m	2019 £m	2020 £m	2019 £m
Current tax				
UK corporation tax charge for the year	5.2	8.1	3.2	5.6
Adjustments in respect of prior years	(1.4)	(0.8)	(1.6)	(0.6)
	3.8	7.3	1.6	5.0
Deferred tax				
Deferred tax charge for year	(1.6)	(0.2)	(1.6)	(0.2)
Adjustments in respect of prior years	1.8	0.5	1.8	0.6
	0.2	0.3	0.2	0.4
Taxation expense	**4.0**	**7.6**	**1.8**	**5.4**

The statutory rate of corporation tax has remained at 19% during 2020 and is expected to remain at 19% through 2021.

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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	
	2020 £m	2019 £m	2020 £m	2019 £m
Profit before taxation	19.9	39.6	19.0	28.2
Profit multiplied by the statutory rate of corporation tax at 19.0% (2019: 19.0%)	3.7	7.5	3.6	5.3
Effects of				
Expenses not deductible for tax purposes	-	0.3	-	0.1
Adjustments to prior years	0.3	(0.2)	(1.8)	-
Taxation on profit from ordinary activities	**4.0**	**7.6**	**1.8**	**5.4**

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	
	2020 £m	2019 £m	2020 £m	2019 £m
Current tax				
Relating to retirement benefit obligations	(0.8)	(0.9)	(0.8)	(0.9)
	(0.8)	(0.9)	(0.8)	(0.9)
Deferred tax				
Relating to retirement benefit obligations	(0.3)	1.0	(0.3)	1.0
Gain on fair value through other comprehensive income	-	0.1	-	0.1
	(0.3)	1.1	(0.3)	1.1
Total charged to other comprehensive income	**(1.1)**	**0.2**	**(1.1)**	**0.2**

13. Loans and advances to credit institutions

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Loans and advances to credit institutions	290.7	202.6	199.3	107.8

Included in the above amount for the group is £164.8m of collateral given under Credit Support Annex (CSA) agreements (2019: £104.1m).

14. Debt securities

	Group and Society	
	2020 £m	2019 £m
Issued by the UK Government	-	90.9
Issued by other borrowers and unlisted	27.8	23.8
Issued by Supranational entities	50.9	50.4
	78.7	**165.1**

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

The movement in debt securities is summarised as follows:

	Group and Society	
	2020 £m	2019 £m
At 1 January	165.1	32.9
Additions	53.4	200.3
Disposals & maturities	(139.9)	(68.9)
Gain from changes in fair value	0.1	0.6
Increase in accrued interest	-	0.2
At 31 December	**78.7**	**165.1**

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15. Derivative financial instruments

The group undertakes transactions in derivative financial instruments, which include 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	
	2020 £m	2019 £m	2020 £m	2019 £m
Derivative assets:				
Interest rate swaps	1,416.8	2,599.4	23.7	21.3
Total recognised derivative assets	**1,416.8**	**2,599.4**	**23.7**	**21.3**
Derivative liabilities:				
Interest rate swaps	4,950.9	4,495.0	106.2	50.4
Total recognised derivative liabilities	**4,950.9**	**4,495.0**	**106.2**	**50.4**

	Society			
	Contract/notional amount		Fair Value	
	2020 £m	2019 £m	2020 £m	2019 £m
Derivative assets:				
Interest rate swaps	2,265.1	3,000.6	23.6	16.5
Total recognised derivative assets	**2,265.1**	**3,000.6**	**23.6**	**16.5**
Derivative liabilities:				
Interest rate swaps	5,091.9	5,275.0	97.2	47.7
Total recognised derivative liabilities	**5,091.9**	**5,275.0**	**97.2**	**47.7**

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	
	2020 £m	2019 £m	2020 £m	2019 £m
Derivatives				
Total derivatives in economic hedge relationships				
Interest rate swaps	370.7	628.7	1,360.1	1,809.9
Total derivatives used as fair value hedges				
Interest rate swaps	5,997.0	6,465.7	5,997.0	6,465.7
Derivative assets in economic hedge relationships				
Interest rate swaps	–	344.1	–	344.1
Derivative assets used as fair value hedges				
Interest rate swaps	1,416.8	2,255.3	2,265.1	2,656.5
Derivative liabilities in economic hedge relationships				
Interest rate swaps	370.7	284.6	370.7	284.6
Derivative liabilities used as fair value hedges				
Interest rate swaps	4,580.2	4,210.4	4,721.2	4,990.4

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	
	2020 £m	2019 £m	2020 £m	2019 £m
Fair value hedges				
Micro hedges				
Commercial loans	112.9	120.1	112.9	120.1
Wholesale	300.0	300.0	300.0	300.0
FV adjustment on hedged item (asset)	(1.7)	1.0	(1.7)	1.0
FV adjustment on hedged item (liability)	5.2	2.1	5.2	2.1
Macro hedges				
Residential and commercial loans	4,456.0	4,563.6	4,456.0	4,563.6
Retail savings	1,097.0	1,457.4	1,097.0	1,457.4
FV adjustment on hedged item (asset)	(39.0)	(20.8)	(39.0)	(20.8)
FV adjustment on hedged item (liability)	2.7	2.5	2.7	2.5
Other underlying adjustments				
Economic hedges – equity	–	(0.9)	–	(0.9)
Amortisation/unwinds	(7.2)	(4.9)	(7.2)	(4.9)

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Hedging strategy outcome				
Micro hedge – asset				
Commercial loans – hedged items	(1.7)	1.0	(1.7)	1.0
Commercial loans – hedged instruments	3.3	1.5	3.3	1.5
Micro hedge – liability				
Wholesale – hedged items	5.2	2.1	5.2	2.1
Wholesale – hedged instruments	(5.2)	(2.2)	(5.2)	(2.2)
Macro hedge – asset				
Residential and commercial loans – hedged items	(39.0)	(20.8)	(39.0)	(20.8)
Residential and commercial loans – hedged instruments	46.1	26.4	46.1	26.4
Macro hedge – liability				
Retail savings – hedged items	2.7	2.5	2.7	2.5
Retail savings – hedged instruments	(2.9)	(2.6)	(2.9)	(2.6)
Economic hedge items				
Equity	–	(0.9)	–	(0.9)
Amortisation/unwinds	(7.2)	(4.9)	(7.2)	(4.9)
Economic hedge instruments				
Dedesignation	(0.3)	(1.2)	(0.3)	(1.2)
Economic hedges – awaiting designation	2.1	(2.4)	2.1	(2.4)
Economic hedges – basis swaps	–	0.5	–	0.5
Economic hedges – equity	–	0.9	–	0.9
Economic hedges – securitisation	–	–	(9.6)	(0.9)

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

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

Group As at 31 December 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
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	–	–	–	–	–	–
Basis interest rate swaps	–	–	–	–	–	–
PIBS swap	–	–	–	–	–	–
Dedesignated swaps	–	–	–	–	–	–
	97.8	**306.0**	**1,031.0**	**4,643.0**	**289.8**	**6,367.6**

Society As at 31 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
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	–	–	–	–	–	–
Basis interest rate swaps	–	–	–	–	–	–
PIBS swap	–	–	–	–	–	–
Dedesignated 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**

15. Derivative financial instruments (continued)

Group As at 31 December 2019	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	–	–	–	47.2	82.2	129.4
PIBS & EMTN interest rate swaps	–	–	–	300.0	–	300.0
Macro hedge						
Retail mortgages interest rate swaps	90.0	214.0	1,252.0	2,941.0	10.0	4,507.0
Commercial interest rate swaps	–	–	3.0	43.8	26.6	73.4
Savings interest rate swaps	80.0	95.0	795.0	486.0	–	1,456.0
Economic hedges						
Retail mortgages interest rate swaps	–	–	–	95.0	180.0	275.0
Commercial interest rate swaps	–	–	–	16.0	2.5	18.5
Savings interest rate swaps	–	–	70.0	–	–	70.0
Basis interest rate swaps	–	–	183.0	–	–	183.0
PIBS swap	–	–	60.0	–	–	60.0
Dedesignated swaps	–	3.2	14.6	0.3	4.1	22.2
	170.0	**312.2**	**2,377.6**	**3,929.3**	**305.4**	**7,094.5**

Society As at 31 December 2019	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	–	–	–	47.2	82.2	129.4
PIBS & EMTN interest rate swaps	–	–	–	300.0	–	300.0
Macro hedge						
Retail mortgages interest rate swaps	90.0	214.0	1,252.0	2,941.0	10.0	4,507.0
Commercial interest rate swaps	–	–	3.0	43.8	26.6	73.3
Savings interest rate swaps	80.0	95.0	795.0	486.0	–	1,456.0
Economic hedges						
Retail mortgages interest rate swaps	–	–	–	95.0	180.0	275.0
Commercial interest rate swaps	–	–	–	16.0	2.5	18.5
Savings interest rate swaps	–	–	70.0	–	–	70.0
Basis interest rate swaps	–	–	183.0	–	–	183.0
PIBS swap	–	–	60.0	–	–	60.0
Dedesignated swaps	–	3.2	14.6	0.3	4.1	22.2
Securitisation interest rate swaps	–	–	–	1,181.1	–	1,181.1
	170.0	**312.2**	**2,377.6**	**5,110.4**	**305.4**	**8,275.6**

Interest Rate Benchmark Reform

Within its hedge accounting relationships, the Society is exposed to GBP LIBOR which is subject to interest rate benchmark reform. The hedged items consist solely of advances to Commercial customers linked to GBP LIBOR.

In addition, the Society has other derivative and non-derivative financial instruments linked to GBP LIBOR that are not included in hedge accounting relationships. Given hedge accounting is not applied in these cases, there is no accounting relief. The fair value of these financial assets and liabilities therefore reflects the uncertainties arising from the interest rate benchmark reforms.

The Society is closely monitoring the market and the output from the various industry working groups managing the transition to new benchmark interest rates. This includes announcements made by LIBOR regulators, including the Financial Conduct Authority (FCA) regarding the transition away from LIBOR (including GBP LIBOR) to the Sterling risk free rate, Sterling Overnight Index Average Rate (SONIA) or other alternative rates.

In response to the announcements, the Society has set up a LIBOR transition programme under the governance of the Chief Financial Officer who reports to the Board. The aim of the programme is to ensure the Society transitions its current LIBOR exposures, including Commercial loans linked to LIBOR, to an alternative benchmark rate by the end of 2021. A project team is in place and an implementation plan has been agreed. Work began on the project in 2019 and has progressed throughout 2020 to ensure the Society achieves a smooth transition by the required deadline.

Below are details of the hedging instruments and hedged items in scope of the IAS 39 amendments due to interest rate benchmark reform, by hedge type. The terms of the hedged items listed match those of the corresponding hedging instruments.

Group As at 31 December 2020	Contract/notional amounts				
	Less than 3 month £m	Between 3 months and 1 year £m	Between 1 year and 5 years £m	More than 5 years £m	Total £m
Fair value hedges – Portfolio hedging of Commercial mortgages					
Receive 3 month GBP LIBOR, pay Sterling fixed rate interest rate swaps	2.8	11.3	23.6	9.0	46.7
Fair value hedges – Micro hedging of Commercial mortgages					
Receive 3 month GBP LIBOR, pay Sterling fixed rate interest rate swaps	–	5.7	42.2	51.6	99.5

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16. Loans and advances to customers

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Fully secured on residential property	8,835.4	8,695.2	8,691.9	8,514.5
Fully secured on land	307.3	311.4	307.3	311.4
	9,142.7	**9,006.6**	**8,999.2**	**8,825.9**
Provision for impairment losses	(34.3)	(25.5)	(28.4)	(19.0)
Effective Interest Rate adjustments	17.3	19.7	13.8	14.5
Fair value adjustment for hedged risk	79.2	32.3	79.2	32.3
	9,204.9	**9,033.1**	**9,063.8**	**8,853.7**

Retail financial services & Secured personal lending

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

Stage	31 December 2020 %	31 December 2019 %
1	86	91
2	13	8
3	1	1

The increase in the proportion of loans in stage 2 compared with the prior year has been largely driven by the deterioration in macro-economic forecasts, together with the treatment of loans subject to COVID-19 related payment holidays as described in note 2.

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

Staging reason	31 December 2020 %	31 December 2019 %
PD grade deterioration	93	85
30-60 days past due	7	14
Forbearance	-	1

Commercial

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

Stage	31 December 2020 %	31 December 2019 %
1	89	92
2	10	6
3	1	2

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

Staging reason	31 December 2020 %	31 December 2019 %
Risk grade deterioration	93	92
30-60 days past due	7	8

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 31 December 2020, the encumbrance ratio was 22.7% (31 December 2019: 23.3%). All other assets are defined as unencumbered.

An analysis of the group's encumbered and unencumbered on-balance sheet assets as at 31 December 2020 and 2019 is set out below.

	2020		2019	
	Encumbered £m	Unencumbered £m	Encumbered £m	Unencumbered £m
Cash in hand & balances at the Bank of England	-	1,438.5	-	1,201.9
Loans and advances to credit institutions	164.8	125.9	198.9	3.7
Debt securities	-	78.7	-	165.1
Derivative financial instruments	-	23.7	-	21.3
Loans and advances to customers	2,354.7	6,850.2	2,288.2	6,744.9
Other assets	-	84.4	-	71.8
Total	**2,519.5**	**8,601.4**	**2,487.1**	**8,208.7**

18. Provision for impairment losses

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)**

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18. Provision for impairment losses (continued)

Group 2019	Retail £m	Commercial lending £m	Secured personal lending £m	Total £m
New loans	1.0	1.8	-	2.8
Settled loans	(1.0)	(3.9)	(1.0)	(5.9)
Changes in model assumptions	(1.2)	(0.2)	(1.1)	(2.5)
Changes in credit quality	3.2	(2.1)	(0.3)	0.8
Balance sheet impact	**(2.0)**	**4.4**	**2.4**	**4.8**
(Utilisation)/recoveries	**(0.3)**	**(1.7)**	**1.3**	**(0.7)**
Income statement impact	**(2.3)**	**2.7**	**3.7**	**4.1**

Provision for impairment losses at 31 December 2020 include £34.3m for loan loss provisioning impairment (2019: £25.5m) and £1.0m on other debt instruments (2019: £0.9m). Total ECL coverage as at 31 December 2020 was 0.22% (2019: 0.21%) in respect of retail financial services and secured personal lending and 1.95% in respect of commercial lending (2019: 0.97%)

In determining ECLs at 31 December 2020, 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 847 loans within the retail portfolio and 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, but we do expect an increased number of customers to experience longer-term financial difficulties after these interventions have ended.

In order to recognise this increased risk, a management overlay of £2.7m (2019: £nil) 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. The number of loans in stage 2 has also increased as a result.

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

Group 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 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 31 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 1 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 31 December 2020	**8,203.6**	**1,196.6**	**56.2**	**9,456.4**

Group 2019	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2019	8,200.7	668.7	62.7	8,932.1
Transfers:				
Stage 1 transfers	(3.7)	-	-	(3.7)
Stage 2 transfers	-	0.5	-	0.5
Stage 3 transfers	-	-	3.2	3.2
New loans	1,772.6	65.0	-	1,837.6
Settled loans	(938.3)	(62.4)	(14.5)	(1,015.2)
Repayments	(239.3)	(16.1)	(2.3)	(257.7)
Gross loan balance at 31 December 2019	**8,792.0**	**655.7**	**49.1**	**9,496.8**

Society 2019	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2019	8,022.0	624.5	49.6	8,696.1
Transfers:				
Stage 1 transfers	(5.8)	-	-	(5.8)
Stage 2 transfers	-	2.3	-	2.3
Stage 3 transfers	-	-	3.5	3.5
New loans	1,772.5	65.0	-	1,837.5
Settled loans	(907.3)	(57.9)	(12.4)	(977.6)
Repayments	(223.9)	(13.1)	(1.7)	(238.8)
Gross loan balance at 31 December 2019	**8,657.3**	**620.8**	**39.0**	**9,317.1**

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

Group 2020	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 model assumptions	1.1	(2.3)	(0.2)	(1.4)
Loss allowance at 31 December 2020	**5.1**	**18.7**	**10.5**	**34.3**

18. Provision for impairment losses (continued)

Society 2020	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 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**

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

Society 2019	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2019	2.9	11.7	7.0	21.6
Transfers:				
Stage 1 transfers	(0.3)	-	-	(0.3)
Stage 2 transfers	-	0.5	-	0.5
Stage 3 transfers	-	-	0.5	0.5
New loans	1.2	1.6	-	2.8
Settled loans	(0.5)	(0.7)	(3.7)	(4.9)
Changes in credit quality	0.3	-	(0.2)	0.1
Changes in model assumptions	(0.1)	(1.2)	-	(1.3)
Loss allowance at 31 December 2019	**3.5**	**11.9**	**3.6**	**19.0**

The following tables show an analysis of expected credit losses by PD band and the average provision coverage within each PD band as at 31 December 2020. The reduction in ECL coverage within the higher PD bands is drive by the run off of the secured personal lending portfolio and also the refinements made to the PD and staging model (as detailed in note 2) which has resulted in a lower concentration of ECLs within the higher PD bands.

Retail and Secured personal lending	2020		2019	
	Sum of ECL £m	Coverage %	Sum of ECL £m	Coverage %
0.00% - 0.11%	-	0.01	0.1	0.00
0.11% - 0.17%	0.3	0.02	0.2	0.01
0.17% - 0.25%	0.6	0.03	0.1	0.02
0.25% - 0.41%	1.1	0.05	0.2	0.03
0.41% - 0.60%	1.0	0.09	0.8	0.26
0.60% - 0.88%	1.3	0.20	0.8	0.46
0.88% - 1.49%	2.0	0.50	2.2	2.04
1.49% - 2.96%	1.4	0.95	1.7	3.06
2.96% - 6.84%	0.6	1.26	1.1	4.50
6.84%+	10.3	7.78	10.3	8.24
Total	**18.5**		**17.5**	

Commercial lending	2020		2019	
	Sum of ECL £m	Coverage %	Sum of ECL £m	Coverage %
PD:				
0.28%	0.2	0.1	0.2	0.1
0.56%	0.3	0.1	0.3	0.1
1.13%	0.9	0.3	1.3	0.4
2.25%	1.9	1.0	1.2	1.0
4.50%	2.7	3.7	1.0	2.8
9.00%	4.7	17.3	1.2	3.3
18.00%	0.5	8.5	1.2	23.7
36.00%	0.3	14.5	0.2	24.5
100.00%	4.4	32.3	1.4	21.2
Total	**15.8**		**8.0**	

18. Provision for impairment losses (continued)

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 2021 to December 2025:

GDP Growth %	Scenario	Weighting at 31 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**

Unemployment (Absolute)	Scenario	Weighting at 31 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 31 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 equivalent scenarios and weightings for the period ending 31 December 2019 were as follows:

GDP Growth %	Scenario	Weighting at 31 December 2019 %	2020	2021	2022	2023	2024
	Base	45.0	3.3	3.2	3.5	3.6	3.9
	Downside	25.0	(0.1)	2.2	3.9	4.4	4.3
	Severe downside	15.0	(5.7)	(1.2)	2.5	4.7	5.4
	Stagflation	15.0	2.1	1.0	2.2	4.5	4.9
	Weighted average		**0.9**	**1.9**	**3.3**	**4.1**	**4.4**

Unemployment (Absolute)	Scenario	Weighting at 31 December 2019 %	2020	2021	2022	2023	2024
	Base	45.0	4.2	4.4	4.6	4.8	4.8
	Downside	25.0	5.0	5.4	5.4	5.3	5.2
	Severe downside	15.0	6.0	7.8	8.2	8.1	7.5
	Stagflation	15.0	4.7	6.2	6.9	6.9	6.6
	Weighted average		**4.8**	**5.4**	**5.7**	**5.7**	**5.6**

HPI %	Scenario	Weighting at 31 December 2019 %	2020	2021	2022	2023	2024
	Base	45.0	1.4	0.6	1.1	1.1	1.8
	Downside	25.0	(0.1)	(3.1)	0.9	2.3	3.0
	Severe downside	15.0	(6.3)	(11.8)	(4.5)	2.3	5.9
	Stagflation	15.0	(1.2)	(4.8)	(3.8)	2.0	5.0
	Weighted average		**(0.7)**	**(3.0)**	**(0.6)**	**1.7**	**3.2**

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	ECL Range £m
Retail financial services	10.4
Secured personal lending	4.5
Commercial lending	3.1

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19. Provision for liabilities

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
At 1 January	4.4	5.1	1.7	1.8
Charge for the year	0.1	0.2	0.1	0.2
Release during the year	(1.7)	(0.9)	(0.5)	(0.3)
At 31 December	**2.8**	**4.4**	**1.3**	**1.7**

At 31 December 2020, the group held a provision of £2.8m (2019: £4.4m) 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 to ensure the provision remains appropriate.

20. Investments in subsidiary undertakings

	Society	
	2020 £m	2019 £m
Shares in subsidiary undertakings	0.1	0.1
Loans to subsidiary undertakings	23.9	68.5
	24.0	**68.6**

	Subsidiary undertakings	
	Shares £m	Loans £m
Movement in investments in subsidiary undertakings:		
At 1 January 2020	0.1	68.5
Loan repayment	–	(44.6)
At 31 December 2020	**0.1**	**23.9**

The Directors have reviewed the recoverability of outstanding loans and holdings in subsidiary undertakings and no impairment provision is deemed necessary.

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.3 PLC, 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.2 PLC was repaid in July 2019 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 28 March 2012. The company is not-for-profit and limited by guarantee. The Society holds no beneficial interest in the company but has agreed to contribute £1 to the assets of the company in the event of it being wound up.

The Society also holds 100% of the ordinary share capital of the following subsidiary undertakings. None of the subsidiary businesses listed below carried out business during the year. All subsidiary businesses were incorporated in the United Kingdom, at the registered address of Principality Buildings, Queen Street, Cardiff, CF10 1UA.

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

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21. Intangible assets

	Group & Society	
	2020 £m	2019 £m
Cost:		
At 1 January	25.7	12.7
Additions	9.7	13.0
At 31 December	**35.4**	**25.7**
Amortisation:		
At 1 January	8.2	8.0
Charge for the year	1.8	0.2
At 31 December	**10.0**	**8.2**
Net book value:		
At 31 December	**25.4**	**17.5**

Computer software capitalised during the year relates to the group's transformation programme and associated technology investment. The total cost at 31 December 2020 includes £3.6m (2019: £17.3m) 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

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 1 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 31 December 2020	**8.1**	**8.1**	**54.5**	**53.4**	**40.5**	**40.5**	**103.1**	**102.0**
Depreciation:								
At 1 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 31 December 2020	**2.0**	**2.0**	**35.5**	**35.0**	**29.1**	**29.1**	**66.6**	**66.1**
Net book value:								
At 31 December 2020	**6.1**	**6.1**	**19.0**	**18.4**	**11.4**	**11.4**	**36.5**	**35.9**
At 31 December 2019	5.3	5.2	20.4	19.8	9.2	9.2	34.9	34.2

2019	Right of use assets		Land and buildings		Equipment, fixtures, fittings & vehicles		Total	
	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m
Cost:								
At 1 January 2019	–	–	44.7	43.5	39.2	31.8	83.9	75.3
Right of use asset upon adoption of IFRS 16	5.9	5.7	–	–	–	–	5.9	5.7
Additions	0.5	0.5	4.9	5.0	2.6	2.6	8.0	8.1
Transfer from investment properties	–	–	4.6	4.6	–	–	4.6	4.6
Disposals	–	–	–	–	(0.2)	(0.2)	(0.2)	(0.2)
At 31 December 2019	**6.4**	**6.2**	**54.2**	**53.1**	**41.6**	**34.2**	**102.2**	**93.5**
Depreciation:								
At 1 January 2019	–	–	30.6	30.1	28.2	20.8	58.8	50.9
Charge for the year	1.1	1.0	1.1	1.1	4.3	4.3	6.5	6.4
Transfer from investment properties	–	–	2.0	2.0	–	–	2.0	2.0
Impairment in the year	–	–	0.1	0.1	–	–	0.1	0.1
Disposals	–	–	–	–	(0.1)	(0.1)	(0.1)	(0.1)
At 31 December 2019	**1.1**	**1.0**	**33.8**	**33.3**	**32.4**	**25.0**	**67.3**	**59.3**
Net book value:								
At 31 December 2019	**5.3**	**5.2**	**20.4**	**19.8**	**9.2**	**9.2**	**34.8**	**34.2**
At 31 December 2018	–	–	14.1	13.4	11.0	11.0	25.0	24.4

Investment properties	Group & Society	
	2020 £m	2019 £m
Cost:		
At 1 January	13.3	17.8
Additions	–	0.1
Disposals	(0.1)	–
Transfers to PPE	–	(4.6)
At 31 December	**13.2**	**13.3**
Depreciation:		
At 1 January	6.4	8.0
Charge for the year	0.3	0.4
Transfers to PPE	–	(2.0)
At 31 December	**6.7**	**6.4**
Net book value:		
At 31 December	**6.5**	**6.9**

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22. Property, plant and equipment (continued)

Included within land and buildings additions is £0.5m (2019: £5.1m) on account of assets in the course of construction. The prior year balance principally related to the redevelopment of the Friary Centre which was completed in February 2020. 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. There were no impairments during 2020 (2019: £0.1m).

The fair value of investment properties as at 31 December 2020 is £11.3m (2019: £14.9m). The comparative value for 2019 (previously disclosed as £9.3m) has been updated to better reflect the proportion of Principality Buildings which is held for investment purposes. No other comparative amounts were affected by this change.

23. Shares

	Group and Society	
	2020 £m	2019 £m
Held by individuals	8,179.6	7,582.9
Other shares	3.6	4.2
Fair value adjustment for hedged risk	4.2	1.4
	8,187.4	**7,588.5**

24. Amounts owed to credit institutions

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Amounts owed to credit institutions	1,026.2	1,072.5	1,601.3	1,783.3

Included in the above amounts is £8.5m of collateral held under Credit Support Annex (CSA) agreements (2019:£3.3m).

25. Debt securities in issue

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Senior unsecured debt	307.0	301.5	307.0	301.5
Residential mortgage backed securities	665.6	806.2	-	-
	972.6	**1,107.7**	**307.0**	**301.5**

26. Other liabilities

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Other taxation and social security	1.0	1.0	1.0	1.0
Lease liabilities	6.1	5.2	6.1	5.1
Other creditors	10.0	7.8	10.0	6.2
	17.1	**14.0**	**17.1**	**12.3**

The undiscounted maturity profile of lease payments at 31 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**

The undiscounted maturity profile of lease payments at 31 December 2019 is shown below:

2019 Group	Property £m	Cars £m	IT Lease £m	Total £m
Year 1	0.8	0.1	0.2	1.1
Year 2	0.7	0.3	0.1	1.1
Year 3	0.7	-	-	0.7
Year 4	0.7	-	-	0.7
Year 5	0.7	-	-	0.7
5 years >	1.8	-	-	1.8
Total	**5.4**	**0.4**	**0.3**	**6.1**

27. Deferred tax

The movement in net deferred tax is as follows:

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
At 1 January	0.6	2.4	0.7	2.2
Income statement charge	0.3	(0.6)	0.1	(0.4)
Statement of other comprehensive income charge	(0.2)	(1.2)	(0.2)	(1.1)
At 31 December	**0.7**	**0.6**	**0.6**	**0.7**

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27. Deferred tax (continued)

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

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Deferred tax assets:				
Retirement benefit obligation	-	0.2	-	0.2
Accelerated tax depreciation	0.7	0.9	0.5	0.8
Fair value through other comprehensive income	-	0.1	-	0.1
Other temporary differences	1.6	0.6	1.7	0.6
	2.3	**1.8**	**2.2**	**1.7**
Deferred tax liabilities:				
Other temporary differences	(1.7)	(1.2)	(1.5)	(1.0)
	(1.7)	**(1.2)**	**(1.5)**	**(1.0)**

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

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Accelerated tax depreciation	(0.3)	(0.2)	(0.2)	(0.1)
Fair value volatility on financial instruments in securitisation entities	1.6	0.2	-	0.2
Other movements	1.5	(0.6)	2.0	(0.4)
	2.8	**(0.6)**	**1.8**	**(0.3)**

The rate of corporation tax from 1 April 2021 will remain at 19%.

The statement of other comprehensive income includes a deferred tax gain of £1.1m (2019: £0.1m loss) arising from the actuarial gain on retirement benefit obligations. The charge reflected in the income statement is not material.

The deferred tax asset relating to retirement benefit obligations is expected to be recovered within five years. More information can be found in note 11.

28. Subscribed capital

	Group and Society	
	2020 £m	2019 £m
7.00% Permanent Interest-Bearing Shares	-	60.0
Fair value adjustment for hedged risk	-	1.2
	-	**61.2**

The Permanent Interest-Bearing Shares (PIBS) were unsecured and denominated in Sterling. They were issued on 1 June 2004 and redeemed in full on 1 June 2020.

29. Financial commitments and contingent liabilities

a) Other provisions for liabilities and charges

At 31 December 2020, the group holds a provision of £2.8m (2019: £4.4m), 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 to ensure the provision remains appropriate.

b) Income receivable under non-cancellable operating leases:

Property rental income earned during the year was £0.6m (2019: £0.7m). At the statement of financial position date, the Society had contracted with tenants for the following future minimum lease payments :

	Group and Society	
	2020 £m	2019 £m
Receivable within one year	0.8	0.8
Receivable between two and five years	3.4	2.8
Receivable after five years	5.6	6.2
	9.8	**9.8**

On 28 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	
	2020 £m	2019 £m	2020 £m	2019 £m
Capital expenditure contracted for but not provided for	3.9	3.6	3.9	3.6

d) Loan commitments:

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
Loan commitments contracted but not paid	112.2	119.5	112.2	119.5

30. Financial instruments

Categories of financial instruments

Financial assets and liabilities are measured on an ongoing basis either at fair value or at amortised cost.

The accounting policies note describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following tables analyse the financial assets and liabilities in the statement of financial position by the class of financial instrument to which they are assigned and by the measurement basis.

Group As at 31 December 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**

Society As at 31 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 & 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 to 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 Group reserves and liabilities				**10,911.6**

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30. Financial instruments (continued)

Categories of financial instruments (continued)

Group As at 31 December 2019	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	1,201.9	–	–	1,201.9
Loans and advances to credit institutions	202.6	–	–	202.6
Debt securities	–	165.1	–	165.1
Derivative financial instruments	–	–	21.3	21.3
Loans and advances to customers	9,033.1	–	–	9,033.1
Total financial assets	**10,437.6**	**165.1**	**21.3**	**10,624.0**
Total non-financial assets				71.8
Total group assets				**10,695.8**
Group liabilities				
Shares	7,588.5	–	–	7,588.5
Amounts owed to credit institutions	1,070.5	–	1.9	1,072.5
Amounts owed to other customers	197.9	–	–	197.9
Debt securities in issue	1,106.0	–	1.7	1,107.7
Derivative financial instruments	–	–	50.4	50.4
Subscribed capital	61.2	–	–	61.2
Total financial liabilities	**10,024.1**	**–**	**54.0**	**10,078.2**
Total non-financial liabilities				34.2
General reserve and other reserves				583.4
Total Group reserves and liabilities				**10,695.8**

Society As at 31 December 2019	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	1,201.9	–	–	1,201.9
Loans and advances to credit institutions	107.8	–	–	107.8
Debt securities	–	165.1	–	165.1
Derivative financial instruments	–	–	16.5	16.5
Loans and advances to customers	8,853.7	–	–	8,853.7
Loans and investments in subsidiaries	68.6	–	–	68.6
Total financial assets	**10,232.0**	**165.1**	**16.5**	**10,413.6**
Total non-financial assets				69.5
Total Society assets				**10,483.1**
Society liabilities				
Shares	7,588.5	–	–	7,588.5
Amounts owed to credit institutions	1,781.4	–	1.9	1,783.3
Amounts owed to other customers	197.9	–	–	197.9
Debt securities in issue	299.8	–	1.7	301.5
Derivative financial instruments	–	–	47.7	47.7
Subscribed capital	61.2	–	–	61.2
Total financial liabilities	**9,928.8**	**–**	**51.3**	**9,980.1**
Total non-financial liabilities				27.5
General reserve and other reserves				475.5
Total Society reserves and liabilities				**10,483.1**

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30. Financial instruments (continued)

Carrying and fair value

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	2020 Carrying value £m	2020 Fair value £m	2019 Carrying value £m	2019 Fair value £m
Group assets					
Cash in hand and balances with Bank of England	i.	1,438.5	1,438.5	1,201.9	1,201.9
Loans and advances to credit institutions	ii.	290.7	298.2	202.6	202.6
Debt securities	iii.	78.7	78.7	165.1	165.1
Derivative financial instruments	iv.	23.7	23.7	21.3	21.3
Loans and advances to customers	v.	9,204.9	9,199.4	9,033.1	9,341.2
		11,036.5	**11,038.5**	**10,624.0**	**10,932.1**
Group liabilities					
Shares	vii.	8,187.4	8,173.2	7,588.5	7,625.0
Amounts owed to credit institutions	viii.	1,026.2	1,026.2	1,072.5	1,072.5
Amounts owed to other customers	viii.	201.3	201.3	197.9	197.9
Debt securities in issue	ix.	972.6	984.9	1,107.7	1,112.7
Derivative financial instruments	iv.	106.2	106.2	50.4	50.4
Subscribed capital	ix.	–	–	61.2	60.6
		10,493.7	**10,491.8**	**10,078.2**	**10,119.1**

	Note	2020 Carrying value £m	2020 Fair value £m	2019 Carrying value £m	2019 Fair value £m
Society assets					
Cash in hand and balances with Bank of England	i.	1,438.5	1,438.5	1,201.9	1,201.9
Loans and advances to credit institutions	ii.	199.3	199.3	107.8	107.8
Debt securities	iii.	78.7	78.7	165.1	165.1
Derivative financial instruments	iv.	23.6	23.6	16.5	16.5
Loans and advances to customers	v.	9,063.8	9,057.2	8,853.7	8,977.8
Loans and advances to subsidiaries	vi.	24.0	24.0	68.6	68.6
		10,827.9	**10,821.3**	**10,413.6**	**10,537.7**
Society liabilities					
Shares	vii.	8,187.4	8,173.2	7,588.5	7,625.0
Amounts owed to credit institutions	viii.	1,601.3	1,601.3	1,783.3	1,783.3
Amounts owed to other customers	viii.	201.3	201.3	197.9	197.9
Debt securities in issue	ix.	307.0	317.5	301.5	306.6
Derivative financial instruments	iv.	97.2	97.2	47.7	47.7
Subscribed capital	ix.	–	–	61.2	60.6
		10,394.2	**10,390.5**	**9,980.1**	**10,021.1**

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, 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, and are considered as a Level 2 item within the hierarchy for fair value.

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 are 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 on page 164.

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.

30. Financial instruments (continued)

Carrying and fair value (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	**102.4**	**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**

	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**

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

	Society			
	2019 £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	16.5	–	13.8	2.7
Financial assets at fair value through other comprehensive income:				
Debt securities	165.1	165.1	–	–
Total	**181.6**	**165.1**	**13.8**	**2.7**
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	–	1.9	–
Debt securities in issue	1.7	1.7	–	–
Derivative financial instruments	47.7	–	42.8	4.9
Total	**51.3**	**1.7**	**44.7**	**4.9**

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.

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30. Financial instruments (continued)

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 2020 are due to changes in market rates.

The costs to replace derivatives contracts in the event that a counterparty was unable to honour their contractual obligation are materially equal to the fair value of derivatives disclosed above.

31. Credit risk

The credit risk to which the group is exposed is described in the Risk Overview on pages 40 to 41. 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	
	2020 £m	2019 £m	2020 £m	2019 £m
In respect of loans and advances to customers:				
Secured by a first charge on residential property	8,691.9	8,514.5	8,691.9	8,514.5
Secured by a first charge on land	307.3	311.4	307.3	311.4
Secured by a second charge on residential property	143.5	180.7	-	-
	9,142.7	9,006.6	8,999.2	8,825.9
Provision for impairment losses	(34.3)	(25.5)	(28.4)	(19.0)
Effective Interest Rate adjustments	17.3	19.7	13.8	14.5
Fair value adjustments	79.2	32.3	79.2	32.3
	9,204.9	**9,033.1**	**9,063.8**	**8,853.7**

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	
	2020 £m	2019 £m	2020 £m	2019 £m
Retail financial services	8,175.7	7,993.5	8,175.7	7,993.5
Commercial lending	808.9	827.9	808.9	827.9
Secured personal lending	141.1	179.4	-	-
Fair value adjustments	79.2	32.3	79.2	32.3
	9,204.9	**9,033.1**	**9,063.8**	**8,853.7**

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	
	2020 %	2019 %	2020 %	2019 %
In Wales	33.5	34.1	30.7	31.1
Outside Wales	66.5	65.9	69.3	68.9
	100.0	**100.0**	**100.0**	**100.0**

The group holds a high quality buy-to-let portfolio with an amortised cost of £2,269.2m (2019: £2,151.2m). At the end of the year, 76% of buy-to-let mortgages were on interest only products, 23% 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 57.9% (2019: 58.7%). Index-linked LTV banding is shown below:

	Group		Society	
	2020 %	2019 %	2020 %	2019 %
Less than 50%	36.1	35.9	35.5	35.3
More than 50% but less than 75%	42.2	40.6	42.7	41.0
More than 75% but less than 90%	16.2	16.9	16.3	17.1
More than 90%	5.5	6.6	5.5	6.6
	100.0	**100.0**	**100.0**	**100.0**

31. Credit risk (continued)

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 0.42% (2019: 0.42%) which compares favourably with the industry average of 0.83% (UK Finance arrears and possession data at 30 September 2020). Residential lending cases fully secured by a first charge which were six months or more in arrears had arrears balances of £1.0m (31 December 2019: £0.8m) with 195 cases (31 December 2019: 164).

The percentage of secured personal loans currently in arrears of two months or more by number is 8.35% (2019: 5.72%), which by value is 9.56% (2019: 5.92%). These increases are due to a combination of an increase in the absolute value of arrears cases in 2020 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			
	2020		2019	
	£m	%	£m	%
Current	8,248.9	99.2	8,100.1	99.1
Past due up to 3 months	34.5	0.4	41.7	0.5
Past due 3 months up to 6 months	13.3	0.2	15.7	0.2
Past due 6 months up to 12 months	11.1	0.1	8.3	0.1
Past due over 12 months	8.9	0.1	6.2	0.1
Possessions	0.4	-	0.9	-
	8,317.1	**100.0**	**8,172.9**	**100.0**

	Society			
	2020		2019	
	£m	%	£m	%
Current	8,122.1	99.4	7,935.8	99.2
Past due up to 3 months	27.1	0.3	31.6	0.4
Past due 3 months up to 6 months	11.9	0.1	14.4	0.2
Past due 6 months up to 12 months	8.0	0.1	6.5	0.1
Past due over 12 months	5.8	0.1	4.4	0.1
Possessions	0.4	-	0.9	-
	8,175.3	**100.0**	**7,993.6**	**100.0**

Collateral values are updated at the date of each statement of financial position based on the best information publicly available. Land Registry data is used in the Retail Financial Services business segment with Nationwide and Hometrack indices being used in the Secured Personal Lending business segment. Both indices take account of the geographical location of the collateral.

Based on indexed valuations the total collateral held in relation to lending secured against residential property is estimated to be £19,233.3m (2019: £18,583.3m).

The group holds collateral against loans and advances to residential customers in the form of mortgage interests over property. £0.2m (2019: £0.5m) 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:

	2020 £m	2019 £m
Retail financial services	12.6	11.0
Secured personal loans	5.9	6.5
	18.5	**17.5**

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31. Credit risk (continued)

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. 2 properties were taken into possession during 2020 (2019: 6) with balances of £0.2m (2019: £0.5m).

The table below sets out the mortgage balances which have had some form of forbearance over the last 12 months. COVID-19 payment holidays are not classified as forbearance; however, any changes following the end of the payment holiday will be classified as forbearance where the relevant criteria are met. Where accounts have had more than one form of forbearance the balance has been categorised based on the first instance of forbearance.

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**

2019	Revised payment schedule £m	Transfer to interest-only £m	Term extensions £m	Other £m	Total £m
Current	10.4	6.8	0.2	1.1	18.5
Past due up to 3 months	7.3	0.4	-	0.1	7.8
Past due 3 months up to 6 months	3.7	-	-	0.3	4.0
Past due 6 months up to 12 months	1.6	-	-	0.3	1.9
Past due over 12 months	0.5	0.2	-	0.4	1.1
	23.5	**7.4**	**0.2**	**2.2**	**33.3**

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 41.

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			
	2020		2019	
	£m	%	£m	%
Loans to Registered Social Landlords secured on residential property	180.2	21.8	168.0	20.0
Other loans secured on residential property	348.1	42.1	368.4	43.9
Loans secured on commercial property	299.1	36.1	302.9	36.1
	827.4	**100.0**	**839.3**	**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			
	2020		2019	
	£m	%	£m	%
Office	105.3	35.2	106.9	35.3
Retail	114.4	38.3	111.8	36.9
Industrial	58.9	19.7	58.1	19.2
Leisure	9.6	3.2	7.6	2.5
Land	1.0	0.3	1.3	0.4
Other	9.9	3.3	17.2	5.7
	299.1	**100.0**	**302.9**	**100.0**

31. 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			
	2020		2019	
	£m	%	£m	%
Wales	385.4	46.7	396.4	47.3
Greater London	249.3	30.1	252.6	30.1
South East/East of England	51.1	6.2	50.8	6.0
Midlands	25.3	3.0	25.8	3.1
South West/South of England	53.2	6.4	51.6	6.1
North West/North of England	18.6	2.2	21.7	2.6
Mixed/other	44.5	5.4	40.4	4.8
	827.4	**100.0**	**839.3**	**100.0**

The average loan to value (LTV) in respect of the group's commercial loans is estimated to be 54.8% (2019: 49.0%). 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.

£25.0m of exposures have an LTV of greater than 100% (2019: £10.8m). Of these, £11.6m are already classified as impaired (2019: £1.3m).

The largest exposure to one counterparty is £27.5m (2019: £29.6m) or 3.3% (2019: 3.5%) of gross balances.

Performance
The commercial lending risk procedure for loans and advances to customers is described in the Risk Overview on page 41.

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):

Region	Group and Society			
	2020		2019	
	£m	%	£m	%
Exposures not classified as higher risk	802.4	97.0	832.2	99.1
Watch-list	13.4	1.6	2.2	0.3
Impaired or past due up to 3 months	11.6	1.4	4.9	0.6
	827.4	**100.0**	**839.3**	**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	180.2	-	-	-	-	-	180.2	21.8
Commercial Investment (including Owner Occupier)	-	7.1	179.1	92.0	4.6	7.9	290.7	35.1
Residential Investment	-	4.5	239.6	48.8	1.9	1.3	296.1	35.8
Commercial Development	-	-	8.2	0.2	-	-	8.4	1.0
Residential Development	-	-	32.9	16.7	-	2.4	52.0	6.3
	180.2	**11.6**	**459.8**	**157.7**	**6.5**	**11.6**	**827.4**	**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			
	2020		2019	
	£m	%	£m	%
Unimpaired				
Current	815.8	98.6	834.4	99.4
Past due 1 to 3 months	-	-	-	-
Impaired				
Past due 3 to 6 months	1.9	0.2	0.7	0.1
Past due 6 to 12 months	-	-	-	-
Past due over 12 months	-	-	-	-
Defaulted but not past due	9.7	1.2	4.2	0.5
Law of Property Act (LPA) Receivers appointed	-	-	-	-
	827.4	**100.0**	**839.3**	**100.0**

31. Credit risk (continued)

a) Loans and advances to customers (continued)

ii) Commercial lending credit risk (continued)

Performance (continued)
There are 5 commercial cases (2019: 3) three months or more in arrears (fixed charge receiver appointed). Total arrears of one month or more are £0.3m (2019: £0.7m).

The total collateral held against commercial loans is estimated to be £1,683m (2019: £1,753m). 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:

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**

2019	Group and Society		
	Stage 1 £m	Stage 2 £m	Stage 3 £m
Commercial lending provisions	2.8	3.7	1.5
Total provisions	**2.8**	**3.7**	**1.5**

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. Such as an extension of a maturity, reduction in interest rate or non-enforcement of covenants recognising that providing such forbearance 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 2020, 20 (2019: 5) accounts with balances totalling £51.9m (2019: £6.7m) in value were granted forbearance concessions.

The total exposure in forbearance at December 2020 stands at balances of £54.3m and 23 accounts (2019: £11.8m, 14 accounts). The potential for losses on these accounts is assessed and considered in the level of overall provisions held against the Commercial lending portfolio. Additionally their status in terms of whether deemed impaired, or placed on the watch-list, is also considered on a regular basis.

b) Treasury financial instruments

The treasury credit risk strategy is described in the Risk Overview on page 41.

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	
	2020 £m	2019 £m	2020 £m	2019 £m
UK Government securities	-	90.9	-	90.9
UK Supranational securities	50.9	50.4	50.9	50.4
UK Financial institutions	268.2	188.0	176.8	93.1
	319.1	**329.3**	**227.7**	**234.4**

None of these exposures was 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 £8.5m (2019: £3.3m) is held over derivative financial instruments.

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

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
AAA to AA-	161.9	193.6	161.9	193.6
A+ to A-	156.3	132.4	64.9	37.5
BBB+ to BBB-	0.9	3.3	0.9	3.3
	319.1	**329.3**	**227.7**	**234.4**

The geographical distribution of these exposures is as follows:

	Group		Society	
	2020 £m	2019 £m	2020 £m	2019 £m
UK	268.2	278.9	176.8	184.0
Multilateral development banks	50.9	50.4	50.9	50.4
	319.1	**329.3**	**227.7**	**234.4**

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.

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32. Liquidity risk

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

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**

2019	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	-	4,098.4	1,634.5	1,854.2	-	7,587.1
Amounts owed to credit institutions	4.8	63.9	11.0	565.9	425.0	1,070.6
Other customers	-	80.0	117.8	-	-	197.8
Debt securities in issue	-	27.2	84.1	994.7	-	1,106.0
Subscribed capital	-	-	0.4	60.0	-	60.4
	4.8	**4,269.5**	**1,847.8**	**3,474.8**	**425.0**	**10,021.9**
Society:						
Non-derivative liabilities						
Shares	-	4,098.4	1,634.5	1,854.2	-	7,587.1
Amounts owed to credit institutions	3.3	89.9	81.5	1,181.7	425.0	1,781.4
Other customers	-	80.0	117.8	-	-	197.8
Debt securities in issue	-	-	0.8	298.9	-	299.7
Subscribed capital	-	-	0.4	60.0	-	60.4
	3.3	**4,268.3**	**1,835.0**	**3,394.8**	**425.0**	**9,926.4**
Group:						
Derivative liabilities						
Interest rate swaps	-	-	3.2	37.6	9.6	50.4
	-	**-**	**3.2**	**37.6**	**9.6**	**50.4**
Society:						
Derivative liabilities						
Interest rate swaps	-	-	3.2	34.8	9.6	47.6
	-	**-**	**3.2**	**34.8**	**9.6**	**47.6**

FINANCIAL STATEMENTS

33. Market risk

Market risk can be sub-divided into interest rate risk and currency risk.

Interest rate risk
Interest rate risk is the risk that the value of, or income arising from, the group's assets and liabilities changes as a result of movements in market rates. The group reviews the potential impact that six interest rate scenarios (a range of parallel and non-parallel market rate shifts) could have on the market value of its financial assets and liabilities, on a discounted cashflow basis. Account is also taken of those assets and liabilities with embedded optionality, such as pipeline and prepayment risk on fixed rate mortgages.

The group monitors its position daily and operates within parameters set by the Board Risk Committee. The results of each of the six interest rate scenarios (parallel and non-parallel) are actively managed by the Finance Committee to ensure they remain consistent with the Society's current interest rate view. As market risk can manifest itself as both an impact on the group's economic value and/or the group's earnings (or Net Interest Income), both metrics are considered when assessing the level of Interest Rate Risk in the Banking Book and are monitored via Finance Committee and the Board Risk Committee. As at 31 December 2020, the Economic Value of the Group's balance sheet would have reduced by £4.6m in the case of a 2% parallel shift upwards.

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

34. Related party transactions

The remuneration of the Directors (including Non-Executive Directors), who are the key management personnel of the group, is set out in the report of the Remuneration Committee.

Loans to and shares held by Directors
There was an aggregate of £0.1m (2019: £0.2m) 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 Buildings, Queen Street, Cardiff, and a statement containing requisite particulars will be available for inspection by Members at the same address for the period of 15 days prior to the Annual General Meeting to be held on 23 April 2021.

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 (2019: £0.1m).

Directors' transactions
There were no other transactions with Directors during the year.

Transactions with group companies
The Society undertook the following transactions with group companies during the year:

	Interest paid to Society £m	Fees paid to Society £m
Year ended 31 December 2020		
Nemo Personal Finance Limited	3.5	-
	3.5	**-**
Year ended 31 December 2019		
Nemo Personal Finance Limited	5.6	0.3
	5.6	**0.3**

At the year-end the following balances were outstanding:

	Loans owed to Society 2020 £m	Loans owed to Society 2019 £m
Nemo Personal Finance Limited	23.9	68.5
	23.9	**68.5**

FINANCIAL STATEMENTS

Annual business statement
for the year ended 31 December 2020

1. Statutory percentages

	At 31 December 2020 %	At 31 December 2019 %	Statutory limit %
The lending limit	3.1	3.6	25.0
The funding limit	22.5	23.9	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

	2020 %	2019 %
As a percentage of shares and borrowings:		
Gross capital	6.1	6.5
Free capital	5.4	5.9
Liquid assets	17.4	15.8
As a percentage of mean total assets:		
Profit for the year as a percentage of statutory mean total assets	0.14	0.31
Management expenses as a percentage of statutory mean total assets	0.73	0.79

- 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 52 to 56.

Details of Directors' service contracts are included in the report of the Remuneration Committee on page 92.

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

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).
Commercial lending	Secured loans to a commercial borrower.
Commercial property	Includes office buildings, industrial property, medical centres, hotels, retail stores, shopping centres, multi-family housing buildings, warehouses and garages.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.

Common Equity Tier 1 capital	The highest quality form of capital as defined in the Capital Requirements Directive IV, comprising accumulated reserves and qualifying instruments after regulatory deductions.
Common Equity Tier 1 capital ratio	Common Equity Tier 1 capital as a proportion of risk-weighted assets.
Cost income ratio	A ratio that represents the proportion of management expenses (i.e. administrative expenses, depreciation and amortisation) to total income.
Covered bonds	A type of wholesale funding backed by cash flows from mortgages.
Credit risk	The risk of financial loss arising from a failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.
Credit Valuation Adjustment (CVA)	An adjustment that represents an estimate of the change to fair value that a market participant would make to incorporate the credit risk inherent in counterparty derivative exposures.
Debt securities in issue	Transferable certificates of indebtedness including certificates of deposits, and fixed and floating rate notes.
Defined benefit pension scheme	A scheme that defines the benefit an employee will receive on retirement, depending on such factors as age, length of service and salary.
Defined contribution pension scheme	A scheme into which the group and the employee pay fixed contributions without any obligation to pay further contributions.
Delinquency	See Arrears.
Effective Interest Rate method (EIR)	The group uses the EIR method to recognise income for certain financial instruments held at amortised cost. To calculate the appropriate EIR, the group makes assumptions of the expected lives of financial instruments and the anticipated level of early redemption charges.
Euro Medium Term Note (EMTN)	Medium term flexible debt instrument.

Glossary (continued)

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 1 April 2013. The FCA also has responsibility for protecting consumers and promoting healthy competition.
Financial Services Compensation Scheme (FSCS)	A protection fund for depositors of failed institutions. This is funded by the financial services industry and each firm, including the Society, is obliged to pay an annual levy.
Forbearance strategies	Strategies to assist borrowers in financial difficulty, such as extending loan terms, temporarily converting loans to an interest-only basis and agreeing a temporary reduction in payments. Forbearance strategies aim, if possible, to avoid foreclosure or repossession.
Funding limit	The proportion of shares and borrowings not in the form of customer accounts held by individuals.
Impaired loans	Loans where there is evidence to suggest a measurable decrease in the present value of expected cash flows that has occurred after initial recognition of the asset, but before the statement of financial position date.
Individually/collectively assessed impairment allowances	Impairment is measured individually for assets and collectively where a portfolio comprises homogenous assets and where appropriate statistical techniques are available. Collective assessment also covers losses that have occurred but are not yet individually identified on loans subject to individual assessment.
Individual Liquidity Guidance (ILG)	Guidance from the PRA on the required quantity of a firm's liquidity resources and the firm's funding profile.
Internal Capital Adequacy Assessment Process (ICAAP)	The group's internal assessment of the levels of capital that need to be held by the Society to meet its regulatory capital requirements.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The group's internal assessment of the levels of liquidity that need to be held by the Society to meet its regulatory liquidity requirements.
International Swaps and Derivatives Association (ISDA) master agreement	A standardised contract developed by ISDA and used to enter into bilateral derivative transactions. The contracts grant legal rights of set-off for derivative transactions with the same counterparty. This reduces the credit risk of the derivatives to the extent that negative values offset positive values.
Internal Ratings Based (IRB)	An approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk sensitive than the standardised approach and may be Foundation or Advanced. IRB approaches may only be used with PRA permission.
Lending limit	The proportion of business assets not in the form of loans fully secured on residential property.
Leverage ratio	A Basel III ratio which measures Tier 1 capital against total on and off balance sheet assets.
LIBOR	London Inter Bank Offered Rate.
Liquid assets	Cash or other assets that can be readily converted to cash without loss of value.
Liquidity Coverage Ratio (LCR)	A liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30 calendar day time horizon under a severe stress scenario.
Liquidity and funding risk	The risk that the group does not hold sufficient liquidity, in terms of quantity and quality, to meet its liabilities as they fall due.
Loan To Value ratio (LTV)	A ratio showing outstanding loan balance as a percentage of the value of the security.
Loss Given Default (LGD)	The difference between Exposure At Default (EAD) and the net amount of the expected recovery expressed as a percentage of EAD.
Management Expense Ratio	A ratio that measures cost as a proportion of mean assets.
Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between the interest received on assets and the interest paid on liabilities.

Glossary (continued)

Net interest margin	This ratio calculates the net interest income as a percentage of mean total assets.
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.
Permanent Interest-Bearing Shares (PIBS)	Unsecured, Sterling denominated Additional Common Equity Tier 1 capital instruments repayable at the option of the Society.
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).

Glossary (continued)

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.
Subscribed capital	See Permanent Interest-Bearing Shares (PIBS).
Tier 1 capital ratio	Tier 1 capital as a proportion of Risk-Weighted Assets.
Tier 2 capital	A further component of regulatory capital comprising subordinated debt less certain regulatory deductions.
Value at Risk (VAR)	A technique that estimates the potential loss that could occur on risk positions as a result of future movements in market rates and prices over a specified time horizon and to a given level of statistical confidence.

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