HALF YEAR
FINANCIAL REPORT

2019

Building your future

Principality
Building Society
Cymdeithas Adeiladu

Where home matters
www.principality.co.uk

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Forward Looking Statements

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

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

Chief Executive's review

I am pleased to announce a good half-year performance from Principality Building Society. We have continued to deliver on our growth strategy in a very challenging market and we have again proved our value in helping support individuals and communities across Wales and the Borders prosper.

Our net retail mortgage lending was £285.6m in the first six months of this year (June 2018: £340.3m), taking our total assets above £10bn for the first time in our history at £10.1bn (December 2018: £9.7bn). This is a fantastic achievement and is testament to the hard work of our colleagues over many years. This growth has been delivered despite continuing economic and political uncertainty, caused in large part by the further delay to Brexit, which has contributed to falling consumer confidence, a subdued housing market and uncertainty over potential changes to the UK base rate.

In order to support the growth in our lending we raised £315m of wholesale funding through our fifth residential mortgage backed securities issuance and attracted an additional £176.0m in savings, with competitively priced products that have maintained our position as one of the best on the High Street. We delivered an average rate to savers of 1.14% compared to the market average of 0.73%[1] over the same period. We have also retained our commitment to the high street with 70 branches and agencies across our heartland as well as fantastic personal service through our customer contact centre.

Balancing the needs of savers whilst remaining competitive in the mortgage market is a constant focus and the savings rates we can offer to Members are directly impacted by the interest we earn on mortgages. Competition in the mortgage market remains high and we have also seen competition increase in the savings market which represents some better news for savers but is resulting in further downward pressure on interest margins. Base rate trajectory continues to be uncertain and undoubtedly will have a further impact on mortgage and savings rates in the months ahead.

As a mutual, member-owned building society, our aim is not to maximise profit but to focus on the long-term future of the Society. Underlying profit before tax was £21.2m compared with £27.4m for the six months to June 2018. This reduction was planned and previously communicated. Business performance is in line with our expectations and continues to be driven by:

- Significant investment in the modernisation of our mortgage and savings technology and investment in branches to meet the changing needs of our Members.
- Higher interest costs from continuing to pay better than average savings rates to our Members and the costs from securing longer-term wholesale funding.
- The run-off of the secured loans business, as we redeploy capital into retail mortgage lending.

Statutory profit before tax was £19.8m (June 2018: £24.9m) which has been impacted by the above factors together with fair value movements in derivatives as set out in the Business Review.

Our capital and liquidity remain strong and provide a solid platform for growth and investment in our business. Being a safe and secure home for our Members' savings is fundamental to the ongoing success of our business and we continue to build scale, strength and resilience for the future.

Our Commercial team has once again made an outstanding contribution to help build our communities, by making £50m available in competitive loans to assist smaller housing developers build homes across Wales. In light of increasing demand we have topped up the fund committed to housing associations in Wales, now having £75m available which will enable them to press ahead with creating much-needed affordable homes. Their outstanding efforts have made a significant contribution towards addressing the Welsh Housing Agenda this year and are a shining example of how Principality is making a difference to our communities.

[1] Source: CACI's CSDB, Stock. Weighted average interest rate comparison for fixed and variable rate products from January to March 2019.

Chief Executive's review (continued)

Robust performance in the first half of the year

The building society has delivered a good trading performance in the first half of the year, with the following key highlights:

- Total assets reached £10.1bn (31 December 2018: £9.7bn)
- Retail mortgage balances of £7,779.8m (31 December 2018: £7,494.3m)
- Savings balances have increased by £176.0m (30 June 2018: £309.3m)
- Gross retail mortgage lending for the first six months of the year of £795.8m (30 June 2018: £912.9m)
- Statutory profit before tax of £19.8m (30 June 2018: £24.9m)
- Underlying profit before tax of £21.2m (30 June 2018: £27.4m)
- 81.3% of mortgages funded by savers (30 June 2018: 84.1%)
- Strong capital with a Common Equity Tier 1 ratio of 24.73%[1] (30 June 2018: 25.21%)
- Customer Service Net Promoter Score at 80.8%[2] (30 June 2018: 79.2%)
- Net interest margin of 1.15% (30 June 2018: 1.29%)

[1] Excluding unaudited interim profits. The equivalent ratio including interim profits at 30 June 2019 would be 25.47%.
[2] Source: Internal survey data for the six months ended 30 June 2019.

Transforming our business

Principality is in the middle of an investment programme to enable us to offer current and future Members a flexible way of managing their savings and mortgage needs. We have an ambitious growth strategy with a clear focus on transforming our mortgage and savings business. Despite our excellent record on customer service, we know we have to keep pace with evolving technology. Our strong performance and profitability supports the significant investment in our technology, branches and colleagues to meet the changing demands of our Members and the world we live in.

We have been working with our Members by testing how we can tailor our digital services to their needs, and invested to make our mortgage journey simpler for brokers, customers and colleagues, allowing faster offer times and a more seamless experience. We will enhance our award winning service in numerous ways by giving brokers access to their cases, an easier registration process, simple document sharing and the removal of manual customer signatures.

We are also in the process of delivering a new savings platform which will benefit our Members and make their lives much smoother with improved digital journeys and propositions including our first digital app.

It is a challenging but exciting period in Principality's history as we look to secure the future of the business for our next generation of savers and borrowers. Whilst our focus is largely technology based, our commitment to the high street remains strong. As long as our Members continue to value and recommend our branches, they will continue to form the bedrock of our service offering.

Members, Communities and Colleagues

I am very proud of the efforts our colleagues have made to improve the lives of others. As a purpose led business, we will continue to work hard to help our communities deal with the many challenges they face.

Principality has partnered with 18 secondary schools across Wales, investing £160,000 and helping thousands of school children to earn the equivalent of a GCSE in financial education.

Chief Executive’s review (continued)

Members, Communities and Colleagues (continued)

Our efforts have been recognised with a Business in the Community Cymru Volunteering Impact award for our work in educating primary school children on financial matters.

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 kindness. This is reflected in our Net Promoter Score which has further improved to 80.8% (31 December 2018: 78.6%) with eight out of ten of our Members saying they would recommend us to family or friends based on their level of satisfaction with Principality.

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

This year we have two new charity partners, Teenage Cancer Trust Cymru and Alzheimer's Society Cymru. Our fundraising for these two outstanding charities got off to a winning start as we donated £10,000 for each of the five victories by Wales as they completed the 2019 rugby union Six Nations Grand Slam. Colleagues have raised a further £50,000, taking the total to an impressive £100,000 in the first six months of the partnership.

Outlook

We expect economic and political uncertainty to continue over the next six months and price competition in the mortgage and savings markets to remain high. Any reduction in the UK base rate would also cause further pressure on margins and could result in changes to rates offered to our Members. Despite these challenges, our profitability and balance sheet position remains robust and our performance in recent years has built a solid foundation for us to invest for the future.

We will continue to seek to grow and invest in our business in a safe and sustainable way for our Members and to make sure we are in a strong position for current and future generations of Members.

Stephen Hughes
Chief Executive
6 August 2019

Business review
for the six months ended 30 June 2019

Key Performance Indicators

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

	Six months to 30 June 2019	Six months to 30 June 2018	Year ended 31 December 2018
Purpose Led Organisation			
Net Retail Mortgage Growth	£285.6m	£313.5m	£718.7m
Brand Consideration	18.8%	20.5%	21.7%
Cost Income Ratio[1]	68.8%	63.4%	66.4%
Brilliant People			
Employee Engagement Score[2]	76.0%	78.0%	76.0%
Stand-Out Experience			
Net Promoter Score[3]	80.8%	79.2%	78.6%
Profit Before Tax	£19.8m	£24.9m	£40.7m
Underlying Profit Before Tax	£21.2m	£27.4m	£43.8m
Net Interest Margin	1.15%	1.29%	1.26%
Common Equity Tier 1 Ratio[4]	24.73%	25.21%	27.06%

[1] The cost income ratio measures management expenses (administration expenses and depreciation and amortisation) as a proportion of total income.
[2] The employee engagement survey is performed annually in the second half of the year.
[3] Source: Internal survey data for the six months ended 30 June 2019.
[4] Excluding unaudited interim profits. The equivalent ratio including unaudited interim profits at 30 June 2019 would be 25.47% for CET1.

The above key performance indicators, apart from profit before tax, are alternative performance measures (APMs) which are used internally to inform key management decisions. Further information on these APMs can be found within the 2018 Annual Report and Accounts within the strategic report and glossary sections.

Financial Performance

Income Statement

Underlying profit before tax was £21.2m (30 June 2018: £27.4m). Statutory profit before tax was £19.8m (30 June 2018: £24.9m). Both measures reflect the ongoing strong performance of the business, and support the ability to invest for the longer term.

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

	30 June 2019 £m	30 June 2018 £m	31 December 2018 £m
Profit before tax	**19.8**	**24.9**	**40.7**
Adjusted for:			
Losses from derivatives and hedge accounting	1.4	2.2	2.4
FSCS levies	-	0.3	-
Additional pension charge for GMP equalisation	-	-	0.7
Underlying profit before tax	21.2	27.4	43.8

The purpose of the underlying profit 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.

Business review (continued)
for the six months ended 30 June 2019

Net Interest Margin

Net interest margin for the period was 1.15% (30 June 2018: 1.29%). This reduction was primarily driven by the continued planned reduction in the loan assets held in the Nemo secured personal lending portfolio to £206.1m (31 December 2018: £236.2m). In addition, competition in the mortgage market has continued to put pressure on margins as older higher margin loans are replaced with newer lower margin lending whilst, at the same time, increasing competition in retail variable savings and uncertainty in wholesale markets is driving up the cost of funding.

Fair Value Movements

Fair value movements represent the change in value of certain assets and liabilities to reflect underlying market rates. These movements are primarily timing differences, which will reverse as the asset or liability approaches maturity. During the period, the group recognised a loss of £1.4m in the income statement (30 June 2018: £2.2m loss) in relation to these movements in fair value.

Operating Expenses

Operating expenses increased in the period to £39.2m (30 June 2018: £38.8m). This is due to investment to transform our core mortgages and savings business. A significant proportion of expenditure on software development has been capitalised as an intangible asset on the group's balance sheet; however, not all costs meet the critieria for capitalisation and have therefore been expensed in the period. Despite this overall increase, focus on managing the core cost base of the business as a proportion of assets remains a priority and this has led to a reduction in the management expense ratio compared with the prior year.

Total operating expenses are set out in the table below:

	30 June 2019 £m	30 June 2018 £m	31 December 2018 £m
Retail financial services	36.7	35.5	75.4
Commercial lending	1.8	1.8	3.7
Secured personal lending	0.7	1.5	2.4
Total operating expenses	39.2	38.8	81.5
Management expense ratio[1]	0.80%	0.83%	0.86%
Cost income ratio	68.8%	63.4%	66.4%

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

Impairment provisions for losses on loans and advances

Impairment provisions for loans and advances to customers was a release of £2.1m (30 June 2018: £2.9m release). This was driven by a continued focus on the resolution of low credit quality loans in the commercial division and secured personal lending portfolio. Arrears performance continues to remain strong across all portfolios, with arrears of more than three months in the retail mortgage portfolio reducing to 0.47% (31 December 2018: 0.49%).

Provisioning levels reflect the prudent approach taken to lending and robust affordability, credit quality and underwriting standards. They also take into account the current uncertain political and economic environment and the potential negative impact it may have on house price growth, levels of employment and arrears levels over the next few years and mean that the business is well positioned to deal with any potential future volatility which may arise.

Business review (continued)
for the six months ended 30 June 2019

Impairment (continued)

Total impairment provisions held are as follows:

	30 June 2019 £m	30 June 2018 £m	31 December 2018 £m
Retail mortgages	10.8	7.0	9.2
Secured personal lending	8.6	9.4	8.9
Commercial lending	10.3	11.2	12.4
Total	29.7	27.6	30.5

Statement of Financial Position

Loans and advances to customers

Total assets have increased to £10,092.4m (31 December 2018: £9,687.4m), driven by growth in retail mortgage lending. The retail mortgage portfolio increased to £7,779.8m (31 December 2018: £7,494.3m), and the quality of the loans remains strong with an average indexed balance to value of 59.4% (31 December 2018: 58.2%). The Commercial lending portfolio increased to £789.9m (31 December 2018: £760.6m), and the Nemo portfolio decreased to £206.1m (31 December 2018: £236.2m).

Funding

Funding levels are closely monitored to maintain a diverse and balanced funding base. The majority of funding comes from retail savings, which increased to £7,165.8m (31 December 2018: £6,989.8m) in the period, reflecting a continued focus on providing competitive products to Members. Wholesale funding also increased with a successful £315.0m RMBS issuance in the first half of 2019.

Capital and Liquidity

The group's Common Equity Tier 1 ratio, which measures qualifying capital reserves as a proportion of risk weighted assets, reduced to 24.73% in the period (31 December 2018: 27.06%). This reduction has been driven by a marginal increase in the level of risk attributed to certain loan assets in the current uncertain economic climate, including impacts of movements in house prices, rather than any reduction in capital levels held. The leverage ratio, which measures Tier 1 capital as a proportion of total on and off balance sheet assets, decreased to 5.3% (31 December 2018: 5.6%).

The capital position remains robust and both ratios are well above the minimum regulatory requirements. The equivalent ratios including interim profits at 30 June 2019 would be 25.47% for CET1 (30 June 2018: 26.22%) and a leverage ratio of 5.4% (30 June 2018: 5.5%).

The business continues to hold a prudent buffer of high quality liquid assets, with a liquidity ratio of 12.7% (31 December 2018: 12.4%). The Liquidity Coverage Ratio (LCR) is 132.5% at 30 June 2019 (31 December 2018: 155.8%), which remains well above the current regulatory minimum of 100%.

Business review (continued)
for the six months ended 30 June 2019

Principal Risks and Uncertainties

The principal risks and uncertainties affecting the group were set out in the Risk Management report of the Annual Report and Accounts for the year ended 31 December 2018. These risks are categorised as: credit, market, liquidity and funding, conduct, operational, business, solvency and legal and regulatory risk, and are common to most financial services firms in the UK.

The group also faces a number of emerging risks, the most significant of which is the competitive market in which it operates for both lending and funding. This is made more challenging by the current uncertain macroeconomic and political environment, driven by various factors including the ongoing Brexit negotiations, uncertainty over potential movements in the UK base rate, geopolitical tensions and difficulties faced by the high street.

Work is underway to ensure an effective transition away from the London Interbank Offered Rate (LIBOR). This is a measure of the average rate at which banks are willing to borrow wholesale unsecured funds. It is a major interest rate benchmark which underpins a significant number of financial contracts including derivatives. However, concerns over its continuing use have resulted in a Bank of England led transition to an alternative by the end of 2021. The group is directly affected by this transition due to its exposure to LIBOR linked commercial lending and derivative contracts.

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

Tom Denman
Chief Financial Officer
6 August 2019

Condensed consolidated income statement
Group interim results for six months to 30 June 2019

	Notes	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
Interest receivable and similar income	3	114.9	110.0	226.0
Interest payable and similar charges	4	(58.7)	(49.7)	(106.4)
Net interest income		56.2	60.3	119.6
Fees and commission receivable	5	2.4	3.2	5.7
Fees and commission payable		(0.8)	(0.8)	(1.6)
Net fee and commission income		1.6	2.4	4.1
Other operating income		0.5	0.6	1.5
Other fair value losses	6	(1.4)	(2.2)	(2.4)
Net operating income		56.9	61.1	122.8
Administrative expenses	7	(35.6)	(35.9)	(75.7)
Depreciation and amortisation		(3.6)	(2.9)	(5.8)
Operating expenses		(39.2)	(38.8)	(81.5)
Impairment credit/(charge) for losses on loans and advances		2.1	2.9	(0.6)
Provisions for liabilities and charges	11	-	(0.3)	-
Operating profit and profit before taxation		19.8	24.9	40.7
Taxation expense	9	(3.6)	(4.2)	(7.8)
Profit for the period/year		16.2	20.7	32.9

Condensed consolidated statement of other comprehensive income
Group interim results for six months to 30 June 2019

	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
Profit for the period/year	16.2	20.7	32.9
Items that will not be reclassified subsequently to profit and loss:			
Actuarial gain on retirement benefit obligations	0.6	4.2	1.1
Tax on retirement benefit obligations	(0.1)	(0.8)	(0.2)
Items that may be reclassified subsequently to profit and loss:			
Gain/(loss) on assets at fair value through other comprehensive income	0.8	(0.5)	(0.7)
Tax on assets at fair value through other comprehensive income	(0.2)	0.1	0.1
Total comprehensive income for the period/year	17.3	23.7	33.2

Condensed consolidated statement of financial position
Group interim results as at 30 June 2019

	Notes	30 June 2019 £m (Unaudited)	30 June 2018 £m (Unaudited)	31 December 2018 £m (Audited)
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		830.5	1,022.2	931.8
Loans and advances to credit institutions		218.5	191.1	147.8
Debt securities		139.0	118.7	32.9
		1,188.0	1,332.0	1,112.5
Derivative financial instruments		22.1	30.8	24.8
Loans and advances to customers:				
Loans fully secured on residential property		8,521.1	7,888.6	8,220.6
Other loans		294.5	281.0	278.1
	10	8,815.6	8,169.6	8,498.7
Intangible fixed assets		11.4	2.6	4.6
Property, plant and equipment		41.1	35.2	34.8
Non current assets classified as held-for-sale		-	4.0	-
Deferred tax assets		2.2	2.6	3.1
Other assets		6.6	4.2	3.0
Prepayments and accrued income		5.4	9.9	5.9
Total assets		10,092.4	9,590.9	9,687.4
Liabilities				
Shares		7,165.8	6,873.1	6,989.8
Deposits and debt securities:				
Amounts owed to credit institutions		1,139.3	749.4	867.1
Amounts owed to other customers		133.6	171.9	141.4
Debt securities in issue		933.4	1,123.5	1,010.9
		2,206.3	2,044.8	2,019.4
Derivative financial instruments		56.4	30.5	31.6
Current tax liabilities		2.7	2.8	2.8
Other liabilities		14.2	8.5	6.2
Provisions for liabilities	11	4.8	6.0	5.1
Accruals and deferred income		9.4	16.0	13.7
Deferred tax liabilities		0.9	1.0	0.6
Retirement benefit obligations	8	1.4	2.4	3.9
Subscribed capital		62.5	65.0	63.6
Total liabilities		9,524.4	9,050.1	9,136.7
General reserve		566.8	540.1	550.1
Other reserves		1.2	0.7	0.6
Total equity and liabilities		10,092.4	9,590.9	9,687.4

Condensed consolidated statement of changes in Members' interests
Group interim results for six months to 30 June 2019

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

	Six months to 30 June 2018 (Unaudited)		
	General Reserve £m	Fair Value through OCI reserve £m	Total equity attributable to Members £m
At 1 January 2018	519.3	1.1	520.4
Changes on initial application of IFRS 9	(4.0)	0.1	(3.9)
Tax effect of IFRS 9 implementation	0.8	-	0.8
Changes on initial application of IFRS 15	0.3	-	0.3
Restated balance at 1 January 2018	516.4	1.2	517.6
Comprehensive income for the period	23.7	(0.5)	23.2
At 30 June 2018	540.1	0.7	540.8

All items dealt with in arriving at the profit for the period, and the preceding financial periods, relate to continuing operations. The accounting policies and notes on pages 13 to 27 form part of these accounts.

Condensed consolidated statement of cash flows
Group interim results for six months to 30 June 2019

	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018* £m (Unaudited)	Year ended 31 December 2018* £m (Audited)
Net cash flows from operating activities	177.9	150.9	55.7
Cash flows from investing activities			
Purchase of intangible assets	(6.9)	(2.1)	(4.2)
Purchase of property, plant and equipment	(3.8)	(4.9)	(7.6)
Purchase of investment securities	(109.6)	-	(6.3)
Proceeds from sale and maturity of investment securities	4.5	5.7	97.1
Proceeds of sale from non current assets	-	-	4.2
Net cash flows from investing activities	**(115.8)**	**(1.3)**	**83.2**
Cash flows from financing activities			
Interest paid on subscribed capital	(2.1)	(2.1)	(4.2)
Interest paid on debt securities in issue	(8.7)	(8.3)	(17.3)
Proceeds from issuance of debt securities in issue	-	11.9	11.9
Redemption of debt securities in issue	(80.9)	(132.9)	(244.8)
Repayments of lease liabilities	(1.0)	-	-
Net cash flows from financing activities	**(92.7)**	**(131.4)**	**(254.4)**
(Decrease)/increase in cash and cash equivalents	(30.6)	18.2	(115.5)
Cash and cash equivalents at beginning of period/year	1,079.6	1,195.1	1,195.1
Cash and cash equivalents at end of period/year	**1,049.0**	**1,213.3**	**1,079.6**
Represented by:			
Cash and balances with the Bank of England	830.5	1,022.2	931.8
Loans and advances to credit institutions repayable on demand	218.5	191.1	147.8
	1,049.0	1,213.3	1,079.6
Operating activities			
Profit before taxation	19.8	24.9	40.7
Adjusted for:			
Depreciation and amortisation	3.6	2.9	5.8
Charge on defined benefit pension scheme	-	-	0.8
Impairment on loans and advances to customers	(2.1)	(2.9)	0.6
Change in fair values	(25.9)	2.3	(2.2)
Equity adjustments for accounting policy changes	-	(3.7)	(3.7)
Interest on debt securities in issue	8.5	8.7	17.5
Interest on subscribed capital	2.1	2.1	4.2
Non-cash items included in profit before tax	0.2	0.3	0.9
Changes in net operating assets			
Loans and advances to customers	(282.8)	(310.6)	(640.4)
Other operating assets	(3.1)	(6.5)	(1.2)
Derivative financial instruments	27.5	0.1	7.2
Shares	172.3	310.9	427.8
Deposits	264.4	132.0	218.4
Other operating liabilities	(1.8)	(0.2)	(5.4)
Contributions paid into defined benefit scheme	(2.0)	(2.4)	(4.6)
Taxation paid	(2.8)	(7.0)	(10.7)
Net cash flows generated from operating activities	**177.9**	**150.9**	**55.7**

* Restated as set out in note 1

Notes to the accounts
for the six months ended 30 June 2019

1. Basis of preparation

The condensed consolidated set of financial statements of the group for the half-year ended 30 June 2019 have been prepared in accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority and with International Accounting Standard (IAS) 34 Interim Financial Reporting, as adopted by the European Union. The annual financial statements of the group are prepared in accordance with IFRSs as adopted by the European Union.

Going concern

The factors considered in determining the long term viability of the group are set out in the 2018 Annual Report and Accounts in the Directors' Report. The Directors are satisfied, based on the latest review undertaken in August 2019, 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.

Accounting policies

The accounting policies adopted are consistent with those of the previous financial year and corresponding interim reporting period, except for the adoption of new and amended standards as set out below.

New and amended standards adopted by the group

A new standard, IFRS 16 Leases, became applicable for the current reporting period. The group has changed its accounting policy for leases as a result of adopting IFRS 16 and the impact of the adoption of this standard is disclosed below.

Amendments to existing standards, together with the introduction of IFRIC 23 Uncertainty over Income Tax Treatments, did not have any impact on the group's accounting policies and did not require retrospective adjustments.

Changes in accounting policies

IFRS 16 specifies how an entity recognises, measures and presents leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases, including bringing those leases previously classified as 'operating leases' onto the balance sheet. IFRS 16's approach to lessor accounting is substantially unchanged from its predecessor, IAS 17.

The group has applied the modified retrospective transition approach, under which the value of the right of use asset is set equal to the value to the lease liability on the date of transition and there is no requirement to restate prior financial periods. In applying IFRS 16 for the first time, the only significant practical expedient taken was to use a single discount rate for all leases with reasonably similar characteristics.

The lease liability was measured as the present value of all remaining lease payments, discounted at the group's incremental borrowing rate. The impact of adopting IFRS 16 is to increase both assets and liabilities by £5.9m on adoption at 1 January 2019. The majority of the adjustment to assets and liabilities relates to the group's branch property portfolio. The right of use asset is held within 'Property, Plant and Equipment' and the lease liability within 'Other Liabilities' on the balance sheet.

Notes to the accounts
for the six months ended 30 June 2019

1. Basis of preparation (continued)

Changes in accounting policies (continued)

Below is a reconciliation between operating lease commitments previously disclosed as at 31 December 2018 and the recognised lease liability at 1 January 2019.

	1 January 2019 £m
Operating lease commitments at 31 December 2018	7.6
IT equipment lease not previously identified	0.4
Impact of discounting at the incremental borrowing rate	(1.6)
Lease liability recognised as at 1 January 2019	6.4
Onerous lease already recognised	(0.5)
Net adjustment on transition as at 1 January 2019	5.9

	1 January 2019 £m
Right-of-use asset by type:	
Properties	5.2
Motor vehicles	0.3
IT equipment	0.4
Total right-of-use asset held	5.9

From 1 January 2019, all leases entered into are recognised as a right of use asset and a corresponding lease liability at the date on which the leased asset is available 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.

Restatements of prior financial periods

Within the condensed consolidated statement of cash flows, cash flows in respect of subscribed capital and debt securities in issue were previously shown within cash flows from operating activities. These have been reclassified as cash flows from financing activities to better reflect the nature of these items.

Notes to the accounts
for the six months ended 30 June 2019

1. Basis of preparation (continued)

Restatements of prior financial periods (continued)

Comparatives have been restated as shown below. Only impacted balances are shown.

Statement of cash flows extract for the six months to 30 June 2018	As previously presented £m	Adjustments £m	As restated £m
Net cash flows from operating activities			
Adjusted for:			
Interest on debt securities in issue	-	8.7	8.7
Interest on subscribed capital	-	2.1	2.1
Non-cash items included in profit before tax	-	0.3	0.3
Changes in net operating assets			
Deposits and debt securities in issue	11.6	(11.6)	-
Deposits	-	132.0	132.0
Movement in subscribed capital	0.1	(0.1)	-
Cash flows from financing activities			
Interest paid on subscribed capital	-	(2.1)	(2.1)
Interest paid on debt securities in issue	-	(8.3)	(8.3)
Proceeds from issuance of debt securities in issue	-	11.9	11.9
Redemption of debt securities in issue	-	(132.9)	(132.9)
	11.7	-	11.7

Statement of cash flows extract for the year ended 31 December 2018	As previously presented £m	Adjustments £m	As restated £m
Cash flows from operating activities			
Adjusted for:			
Interest on debt securities in issue	-	17.5	17.5
Interest on subscribed capital	-	4.2	4.2
Non-cash items included in profit before tax	0.8	0.1	0.9
Changes in net operating assets			
Proceeds from debt securities in issue	0.3	(0.3)	-
Redemption of debt securities in issue	(233.0)	233.0	-
Movement in subscribed capital	0.1	(0.1)	-
Cash flows from financing activities			
Interest paid on debt securities in issue	-	(17.3)	(17.3)
Proceeds from issuance of debt securities in issue	-	11.9	11.9
Redemption of debt securities in issue	-	(244.8)	(244.8)
Interest paid on subscribed capital	-	(4.2)	(4.2)
	(231.8)	-	(231.8)

These restatements had no impact on either the group's net assets or Member's interests, or on cash and cash equivalents at either 30 June or 31 December 2018.

1. Basis of preparation (continued)

Impact of standards issued but not yet applied

There are no material impacts expected from issued standards that are not yet applicable.

Judgements in applying accounting policies and critical accounting estimates

There are no significant judgements made in applying the group's accounting policies. The areas of critical accounting estimates remain consistent with those disclosed in the 2018 Annual Report and Accounts, being impairment provisions on loans and advances (note 14), retirement benefit obligations (note 8) and provisions for customer and regulatory complaints (note 11).

2. Business segments

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

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

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

	Six months to 30 June 2018 (Unaudited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	45.3	7.2	7.8	60.3
Other income and charges	0.1	0.6	0.1	0.8
Net operating income	45.4	7.8	7.9	61.1
Operating expenses	(35.5)	(1.8)	(1.5)	(38.8)
Impairment provision for losses on loans and advances	(0.1)	2.2	0.8	2.9
Provision for other liabilities and charges	(0.3)	-	-	(0.3)
Operating profit and profit before taxation	9.5	8.2	7.2	24.9
Taxation expense				(4.2)
Profit after taxation				20.7

Notes to the accounts
for the six months ended 30 June 2019

2. Business segments (continued)

	Year ended 31 December 2018 (Audited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	90.6	14.6	14.4	119.6
Other income and charges	1.5	1.6	0.1	3.2
Net operating income	92.1	16.2	14.5	122.8
Operating expenses	(75.5)	(3.6)	(2.4)	(81.5)
Impairment provision for losses on loans and advances	(2.4)	0.5	1.3	(0.6)
Provision for other liabilities and charges	-	-	-	-
Operating profit and profit before taxation	14.2	13.1	13.4	40.7
Taxation expense				(7.8)
Profit after taxation				32.9

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

	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
Total assets by business segments			
Retail financial services	9,068.1	8,527.1	8,679.4
Secured personal lending	207.9	273.6	236.7
Commercial lending	816.4	790.2	771.3
Total assets	10,092.4	9,590.9	9,687.4
Total liabilities and equity by business segment			
Retail financial services and Commercial lending	9,884.5	9,317.3	9,450.7
Secured personal lending	207.9	273.6	236.7
Total liabilities and equity	10,092.4	9,590.9	9,687.4

3. Interest receivable and similar income

	Group		
	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
On loans fully secured on residential property	109.7	107.1	222.5
On other loans	4.7	5.7	5.8
On debt securities	0.5	0.7	1.1
On other liquid assets	3.8	3.1	6.5
On derivative financial instruments	(3.8)	(6.6)	(9.9)
	114.9	110.0	226.0

Notes to the accounts
for the six months ended 30 June 2019

4. Interest payable and similar charges

	Group		
	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
On shares held by individuals	44.3	39.7	83.1
On deposits and debt securities	14.2	11.5	24.8
On subscribed capital	2.1	2.1	4.2
On lease liabilities	0.1	-	-
On derivative financial instruments	(2.0)	(3.6)	(5.7)
	58.7	49.7	106.4

5. Fees and commission receivable

	Group		
	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
Insurance and related financial service products	0.7	0.9	1.6
Mortgage related fees	1.6	2.2	3.9
Other fees and commission	0.1	0.1	0.2
	2.4	3.2	5.7

6. Other fair value gains and losses

	Group		
	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
(Losses)/gains on derivatives in hedging relationships	(26.8)	0.2	(4.3)
(Losses)/gains on derivatives not in hedging relationships	(0.5)	(0.2)	(1.0)
(Losses)/gains on derivatives	(27.3)	-	(5.3)
Gains/(losses) on economic hedged items	3.2	2.2	4.5
Gains/(losses) on hedged items attributable to hedged risk	22.7	(4.4)	(1.6)
Gains/(losses) on hedged items	25.9	(2.2)	2.9
	(1.4)	(2.2)	(2.4)

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

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for the six months ended 30 June 2019

7. Administrative expenses

	Group		
	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
Wages and salaries	18.5	19.5	38.8
Social security costs	1.9	1.9	3.8
Other pension costs	1.1	1.1	2.7
	21.5	22.5	45.3
Other administrative expenses	14.1	13.4	30.4
	35.6	35.9	75.7

8. Retirement benefit obligations

	Group		
	30 June 2019 £m (Unaudited)	30 June 2018 £m (Unaudited)	31 December 2018 £m (Audited)
Fair value of plan assets	71.7	63.5	63.0
Present value of funded and unfunded obligations	(73.1)	(65.9)	(66.9)
Pension scheme deficit	(1.4)	(2.4)	(3.9)

The deficit has decreased primarily as a result of contributions of £2.0m paid by the Society during the period.

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

	Group	
	Increase 0.5% £m	Decrease 0.5% £m
Discount rate	(5.8)	6.6
Inflation	6.5	(5.8)
Life expectancy (+1 year/ -1 year)	2.7	(2.9)

Notes to the accounts
for the six months ended 30 June 2019

9. Taxation

Taxation for the group for the 6 months to 30 June 2019 is charged at 18.2% (30 June 2018: 16.9%), representing the best estimate of the annual effective tax rate expected for the full year, applied to the forecast pre-tax income for the year and pro-rated for the six-month period. The effective statutory rate of of corporation tax for the year ending December 2019 is 19.0%. The statutory rate of corporation tax will be reduced to 17.0% from 1 April 2020.

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

	Group		
	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
Profit before tax	19.8	24.9	40.7
Profit multiplied by the standard rate of corporation tax at 19.00% (2018: 19.00%)	3.8	4.7	7.7
Effects of:			
Expenses not deductible for tax purposes	-	-	0.1
Other	(0.2)	(0.5)	-
Tax charge	3.6	4.2	7.8

10. Loans and advances to customers

	Group		
	30 June 2019 £m (Unaudited)	30 June 2018 £m (Unaudited)	31 December 2018 £m (Audited)
Fully secured on residential property	8,490.3	7,878.9	8,216.6
Fully secured on land	294.5	290.0	282.8
	8,784.8	8,168.9	8,499.4
Provision for impairment losses	(29.7)	(27.6)	(30.5)
Unamortised loan origination fees	20.8	23.4	22.2
Fair value adjustment for hedged risk	39.7	4.9	7.6
	8,815.6	8,169.6	8,498.7

11. Provisions for liabilities

	Group		
	30 June 2019 £m (Unaudited)	30 June 2018 £m (Unaudited)	31 December 2018 £m (Audited)
At beginning of the period/year	5.1	6.1	6.1
Additions	-	0.3	-
Utilisation	(0.3)	(0.4)	(1.0)
At end of the period/year	4.8	6.0	5.1

11. Provisions for liabilities (continued)

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

Although a significant degree of uncertainty remains with regard to the ultimate cost of settling customer claims, the provision balance is expected to be sufficient to meet any remaining obligations. Further details are set out in note 19 of the 2018 Annual Report and Accounts.

12. Related party transactions

The group had no related party transactions outside the normal course of the business during the six months to 30 June 2019. Transactions for this period are similar to those for the year to 31 December 2018, details of which can be found in note 35 of the 2018 Annual Report and Accounts.

13. Financial instruments

Carrying values and fair values

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

	30 June 2019		31 December 2018	
	Carrying Value £m (Unaudited)	Fair Value £m (Unaudited)	Carrying Value £m (Audited)	Fair Value £m (Audited)
Total assets				
Cash in hand and balances with Bank of England	830.5	830.5	931.8	931.8
Loans and advances to credit institutions	218.5	218.6	147.8	147.8
Debt securities	139.0	139.0	32.9	32.9
Derivative financial instruments	22.1	22.1	24.8	24.8
Loans and advances to customers	8,815.6	8,920.2	8,498.7	8,594.8
	10,025.7	10,130.4	9,636.0	9,732.1
Total liabilities				
Shares	7,165.8	7,177.6	6,989.8	6,999.4
Amounts owed to credit institutions	1,139.3	1,139.3	867.1	867.1
Amounts owed to other customers	133.6	133.6	141.4	141.4
Debt securities in issue	933.4	934.2	1,010.9	998.5
Derivative financial instruments	56.4	56.4	31.6	31.6
Subscribed capital	62.5	60.0	63.6	61.0
	9,491.0	9,501.1	9,104.4	9,099.0

Further details on the methods and assumptions which have been applied in determining fair value are set out in note 31 of the 2018 Annual Report and Accounts.

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13. Financial instruments (continued)

Assets and liabilities measured at fair value

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

	30 June 2018 (Unaudited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	30.8	-	26.3	4.5
Financial assets at fair value through other comprehensive income:				
Debt securities	118.7	118.7	-	-
Total	149.5	118.7	26.3	4.5
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	15.0	-	15.0	-
Derivative financial instruments	30.5	-	26.0	4.5
Total	45.5	-	41.0	4.5

	31 December 2018 (Audited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	24.8	-	21.0	3.8
Financial assets at fair value through other comprehensive income:				
Debt securities	32.9	32.9	-	-
Total	57.7	32.9	21.0	3.8
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	4.3	-	4.3	-
Derivative financial instruments	31.6	-	27.8	3.8
Total	35.9	-	32.1	3.8

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

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for the six months ended 30 June 2019

13. Financial instruments (continued)

Hierarchy for fair value disclosures

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

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

14. Credit risk

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

i) Loans and advances to customers

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

	Group		
	30 June 2019 £m (Unaudited)	30 June 2018 £m (Unaudited)	31 December 2018 £m (Audited)
In respect of loans and advances to customers:			
Secured by a first charge on residential property	8,281.9	7,605.6	7,979.3
Secured by a first charge on land	294.5	290.0	282.7
Secured by a second charge on residential property	208.5	273.3	237.4
	8,784.9	8,168.9	8,499.4
Provisions for impairment losses	(29.7)	(27.6)	(30.5)
Effective interest rate adjustments	20.7	23.4	22.2
Fair value adjustments	39.7	4.9	7.6
	8,815.6	8,169.6	8,498.7

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

	Retail Financial Services		Commercial Lending		Secured Personal Lending	
Stage	30 June 2019 £m (Unaudited)	31 December 2018 £m (Audited)	30 June 2019 £m (Unaudited)	31 December 2018 £m (Audited)	30 June 2019 £m (Unaudited)	31 December 2018 £m (Audited)
1	7,557.0	7,290.9	769.3	731.0	155.9	178.9
2	545.2	510.4	121.4	114.1	39.7	44.2
3	39.8	39.7	7.4	9.9	11.8	13.1
	8,142.0	7,841.0	898.1	855.0	207.4	236.2

14. Credit risk (continued)

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

	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
Retail financial services	10.8	7.0	9.2
Secured personal lending	8.6	9.4	8.9
Commercial lending	10.3	11.2	12.4
	29.7	27.6	30.5

The average index-linked loan balance to value (BTV), in respect of the group's loans secured by a first or second charge on residential property, is 59.4% (31 December 2018: 58.2%).

The percentage of retail lending cases fully secured by a first charge, currently with arrears greater than three months, is 0.47% (31 December 2018: 0.49%) which compares favourably with the industry average of 0.78%[1].

Residential lending cases fully secured by a first charge which were six months or more in arrears had arrears balances of £0.9m (31 December 2018: £0.8m) with 198 (31 December 2018: 174) cases.

The percentage of secured personal loans currently in arrears by two months or more by number is 5.94% (31 December 2018: 4.76%), which by value is 5.67% (31 December 2018: 5.73%).

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

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

Sensitivity analysis has been performed on the staging criteria and probability of default (PD) models used to determine expected credit loss provisions. A 10% variance has been selected as this is deemed to be a reasonable variation which could occur over a 12 month period in the current economic environment. The impact of 10% of loans currently in stage 1 moving to stage 2 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	0.4	0.1	0.2
Stage 2 to Stage 1	(0.4)	(0.3)	(0.1)

[1] Source: UK Finance arrears and possession data as at March 2019.

14. Credit risk (continued)

The impact of a 10% change in the PD rates is as follows:

Retail financial services £m	Secured personal lending £m	Commercial lending £m
0.9	0.7	0.6

Forward looking economic scenarios
Forecasts of economic variables together with probability weightings are supplied by an external provider. Economic scenarios have been selected which take account of a range of possible economic outcomes. The scenarios, together with the weightings and average values of the key variables over the three years to 2021, are set out in the table below:

Scenario	Weighting on 30 June 2019 %	GDP growth %	Unemployment growth %	House price growth %
Base	44.7	3.8	0.9	1.1
Stronger near term growth	10.7	6.1	(0.5)	4.9
Slower near term growth	26.8	2.4	1.6	(1.0)
Protracted slump	7.1	(0.7)	4.5	(7.2)
Stagflation	10.7	2.3	3.1	(3.3)
Weighted average at 30 June 2019		*3.2*	*1.4*	*(0.1)*
Weighted average at 31 December 2018		*3.2*	*1.3*	*0.2*

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

In addition to applying the scenarios and weightings set out above, further allowance has been made for the impact of the UK not achieving an orderly exit from the EU by the revised deadline of 31 October 2019. This allowance, which totalled £3.1m at 30 June 2019 (31 December 2018: £3.6m), has been determined by increasing the probability that factors impacting the determination of ECLs will be more to the downside than the existing weightings assume. This adjusts the weighted average of the forecast scenarios to a 2.4% fall in house prices, 2.3% increase in unemployment and an increase in GDP of 1.9% (31 December 2018: a 3.0% fall in house prices, 2.8% increase in unemployment and an increase in GDP of 1.6%).

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14. Credit risk (continued)

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 (protracted slump) and the most optimistic scenario (stronger near term growth).

Portfolio	ECL Range £m
Retail financial services	14.2
Secured personal lending	7.2
Commercial lending	2.0

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

	Group			
	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2019	3.8	16.8	10.7	31.3
Transfers:				
Stage 1 transfers	(0.6)	-	-	(0.6)
Stage 2 transfers	-	2.5	-	2.5
Stage 3 transfers	-	-	0.3	0.3
New loans	0.3	0.2	-	0.5
Settled loans	(0.2)	(0.4)	(0.5)	(1.1)
Changes in credit quality	0.1	0.6	(0.7)	-
Changes in loan model assumptions	(0.5)	(1.9)	-	(2.4)
Loss allowance at 30 June 2019	2.9	17.8	9.8	30.5

	Group			
	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2018	4.1	12.4	17.8	34.3
Transfers:				
Stage 1 transfers	0.2	-	-	0.2
Stage 2 transfers	-	1.6	-	1.6
Stage 3 transfers	-	-	0.8	0.8
New loans	0.8	1.0	-	1.8
Settled loans	(0.6)	(0.7)	(8.7)	(10.0)
Changes in credit quality	(0.7)	(0.7)	(0.7)	(2.1)
Changes in loan model assumptions	-	3.2	1.5	4.7
Loss allowance at 31 December 2018	3.8	16.8	10.7	31.3

14. Credit risk (continued)

ii) Commercial

Loans secured on commercial property are diversified by industry type with the largest exposure to one counterparty amounting to £29.6m (31 December 2018: £29.6m) or 3.7% (31 December 2018: 3.8%) of gross balances.

Asset quality remains strong with impaired balances of £7.4m (31 December 2018: £9.9m), or 0.9% of gross balances (31 December 2018: 1.3%).

iii) Treasury

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

Provisions for expected credit losses in relation to treasury instruments of £0.8m were held at 30 June 2019 (31 December 2018: £0.8m).

15. Notes to the cash flow statement

The following table reconciles the movements for other operating assets and liabilities:

	6 months to 30 June 2019 £m (Unaudited)	6 months to 30 June 2018 £m (Unaudited)	Year ended 31 December 2018 £m (Audited)
Other operating assets			
Increase in other assets	(3.6)	(2.6)	(1.4)
Decrease/(increase) in prepayments and accrued income	0.5	(3.9)	0.2
	(3.1)	(6.5)	(1.2)
Other operating liabilities			
Increase/(decrease) in other liabilities	2.9	1.4	(0.7)
Decrease in provisions for liabilities	(0.3)	(0.1)	(1.0)
Decrease in accruals and deferred income	(4.4)	(1.5)	(3.7)
	(1.8)	(0.2)	(5.4)

Responsibility statement

We confirm that to the best of our knowledge:

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

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

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

By order of the Board,

Stephen Hughes
Chief Executive Officer
6 August 2019

Independent review report to Principality Building Society

We have been engaged by the Society to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2019 which comprises the condensed consolidated income statement, the condensed consolidated statement of other comprehensive income, the condensed consolidated statement of financial position, the condensed consolidated statements of Members' interests, the condensed consolidated statement of cash flows and related notes 1 to 15. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

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

Directors' responsibilities

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

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

Our responsibility

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

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2019 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Deloitte LLP
Statutory Auditor
Cardiff, United Kingdom
6 August 2019

Other information

The information for the period ended 30 June 2019 is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986. The financial information for the year ended 31 December 2018 has been extracted from the Annual Report and Accounts for that year. The annual accounts for the year ended 31 December 2018 have been filed with the Financial Conduct Authority.

The auditor's report on the 2018 Annual Report and Accounts was not qualified and did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report.

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

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HYFR 2019 06/19-1

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