Half Year Financial Report 2023

Building your future

Principality
Building Society
Cymdeithas Adeiladu

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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

Interim Report

The first half of 2023 has been another challenging period for our members, colleagues and communities. Core inflation has remained stubbornly high, leading to further Bank of England base rate rises, which has added to the cost-of-living pressure on people's finances.

I am pleased to announce a strong performance for the first half of the year whilst we have continued to support our Members and communities through these turbulent economic times.

Principality is a purpose-led, Member owned organisation. Our ambition to have impact beyond our scale and to grow the business sustainably for future generations is making real progress. We have delivered mortgage and savings growth in the last six months, whilst improving our efficiency with better online and branch services.

Our Member owned, sustainable business model, responsible approach to lending and conservative interest rate risk management have enabled us to balance the needs of savers and borrowers while also keeping the Society safe and secure for the long term.

While others are closing branches, we remain committed to the high street, helping to provide increased choice and services for Members, customers, colleagues, and our broker partners.

Better Homes

In the first half of the year, we helped more than 3,300 first time buyers to purchase their home (June 2022: 1,936) and our net retail mortgage lending growth was £453.9m (June 2022: £103.5m) returning to previous levels post Pandemic and IT investment.

We are committed to supporting our Members during these challenging times and have signed up to the UK Government's Mortgage Charter. This will give customers, who are worried about meeting their mortgage repayments, confidence that real help is at hand. We will continue to reach out to mortgage members to reassure them that our team is here to help them if they need support with any financial difficulties although we have not seen any significant change in the level of retail mortgages forbearance or arrears over the first six months of 2023.

I am proud of the service our colleagues provide and investment this year has seen sustainable improvements in the experience we provide to our brokers and customers. This led to us being voted Best Building Society for Customer Service by What Mortgage for the sixth consecutive year.

In February, our Commercial team issued a £50m loan to Pobl, one of the largest housing associations in Wales, to support the creation of more affordable housing across Wales and to encourage more energy efficient homes to be created. This led to the Commercial team winning the Funder of the Year award at the Insider Wales Property Awards.

Secure Future - Society of savers

We want to provide our Members with competitive savings rates so we can create a society of resilient savers.

Savings performance has been strong; we have increased the number of savers we have to over 415,000 with over 75,000 customers saving regularly. This is the result of amazing commitment from all our colleagues who worked tirelessly to ensure we put savings members at the heart of our response to recent Bank of England rate increases.

Around 1% out of the 1.5% in BOE rate rises in the first half of the year were passed on to our savers and our average time to increase savings rates after a base rate increase has halved from a month to 15 days giving Members value more quickly.

On average we have paid savers 2.46% versus the market average of 1.87% for the first five months of 2023* resulting in the equivalent of an additional £10m in interest to our variable rate savers.

**Source: CACI's Current Account and Savings Database, Stock, Jan – May 2023*

Chief Executive's review (continued)

Fairer Society - Greater social impact for communities

We have the ambition to set aside up to 3% of our annual profit for social purpose, and as part of that commitment, in the first half of this year, we have invested 1.4% (£569,000) of our underlying profits in community grants through our Future Generations Fund.

We have helped to financially educate almost 33,000 school children and young people in the past six months, whilst donating £86,000 to charity partners Ty Hafan and Hope House Ty Gobaith children's hospices.

Principality is committed to diversity and inclusion, and our excellent colleague networks have made big strides in recent years helping us on this journey. One example is how our Pride network has reached out to businesses across Wales, to demonstrate how we can work collaboratively in the private sector to help achieve Welsh Government's LGBTQ+ Action Plan.

Strong Financial Performance

The rising interest rate environment underpinned improved net interest margin of 1.69% (June 2022: 1.32%). We have benefitted from our historic long-term interest rate risk management decisions which have allowed us to offer highly competative rates to savers and protect variable rate mortgage customers from the full impact of the Bank of England Rate.

Underlying profit reached £39.1m (June 2022: £26.1m) whilst statutory profit before tax was £41.0m (June 2022: £31.0m). Mortgage balances are £8.7bn (December 2022: £8.2bn) and savings balances are now £8.5bn (December 2022: £8.1bn).

Our capital and liquidity remain strong and enable a platform for future growth and investment in our business. Providing a safe and secure home for our Members' savings is fundamental to the ongoing success of our business.

Outlook

There is no doubt that economic conditions will remain challenging for many people in the medium-term, with some further interest rate rises expected from the Bank of England in its attempts to ease inflationary pressure.

However, our long-term ambition remains unchanged; to create better homes for Members, help Members to secure their futures with competitive saving rates, as well as trying to create a fairer society for the communities we operate in. In doing this, we will build more scale, strength and resilience for the future.

Julie-Ann Haines
Chief Executive Officer
4 August 2023

Business review
for the six months ended 30 June 2023

Strategic Key Performance Indicators

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

2023 Strategic Key Performance Indicators (SKPIs)

Better Homes	Secure Futures	Fairer Society
Total number of homeowners	Total number of savers	Amount of funds distributed for social impact activity
Total number of first time buyers	Total number of customers saving regularly	Percentage of women in leadership positions (reintroduced March 2023)
Total new homes funded	Total number of young people accessing opportunities	
Total committed to new RSL lending		

Better Homes

SKPI	2023 HY	2022 HY	2022
Total number of homeowners	77,766	76,044	75,425
Total number of first time buyers	3,304	1,936	4,587
Total new homes funded	20	79	213
Total committed to new RSL lending	£17.0m	£19.0m	£69.0m

Secure Futures

SKPI	2023 HY	2022 HY	2022
Total number of savers	415,765	397,249	407,046
Total number of customers saving regularly	77,523	40,066	63,873
Total number of young people accessing opportunities	32,772	18,272	28,867

Fairer Society

SKPI	2023 HY	2022 HY	2022
Amount of funds distributed for social impact activity	£0.6m	£0.4m	£0.7m
Percentage of women in leadership positions	40	34	39

Business review (continued)
for the six months ended 30 June 2023

Key Performance Indicators

The below performance indicators, apart from profit before tax, are alternative performance measures (APMs) which are used internally to inform key management decisions.

	Six months to 30 June 2023	Six months to 30 June 2022	Year ended 31 December 2022
Financial Performance Measures			
Net Retail Mortgage growth/(reduction)[1]	£453.9m	£103.5m	£208.5m
Net Savings growth/(reduction)[2]	£398.1m	£(5.8)m	£175.2m
Net interest Margin	1.69%	1.32%	1.39%
Management Expense	0.95%	0.85%	0.90%
Statutory Profit Before Tax	£41.0m	£31.0m	£49.3m
Underlying Profit Before Tax	£39.1m	£26.1m	£43.5m
Common Equity Tier 1 Ratio[3]	24.85%	32.01%	26.50%
Stakeholder Experience			
Employee Engagement (annual)[4]	87	87	86
Customer Experience[5]	83	81	82
Broker Experience (6 month rolling average)[6]	78	57	68

1. This movement is calulated excluding any fair value amount attributed to retail mortgages. The difference in fair value adjustments between December 2022 and June 2023 was £20.6m.
2. This movement is calulated excluding any fair value amount attributed to savings. The difference in fair value adjustments between December 2022 and June 2023 was £12.5m.
3. The reduction in CET1 is due to a post model adjustment that has been applied to reflect the anticipated changes as a result of the revised IRB model currently under development.
4. Source: Based on the Peakon Engagement Platform for June 2023, Great Place to Work survey for comparative periods. The result is the percentage of employees who engaged and completed the survey.
5. Source: Based on Maze survey customer data for the 6 months ended 30 June 2023.
6. Source: Based on Maze survey broker data for the 6 months ended 30 June 2023. This is a new measure first reported in 2022.

The above key performance indicators, apart from profit/loss before tax, are alternative performance measures (APMs) which are used internally to inform key management decisions. Further information on these APMs can be found within the 2022 Annual Report and Accounts within the strategic report and glossary sections.

Financial performance

Income statement

As detailed in the Chief Executive's review, the underlying profit before tax for the six months to 30 June 2023 was £39.1m (30 June 2022: £26.1m). Statutory profit before tax was £41.0m (30 June 2022: £31.0m). Both measures reflect the ongoing strong performance of the Society, enabling the Society to support members and colleagues, and invest in the long-term.

	30 June 2023 £m	30 June 2022 £m	31 December 2022 £m
Statutory Profit Before Tax	**41.0**	**31.0**	**49.3**
Adjusted for:			
Fair value gains	(1.9)	(4.9)	(5.8)
Underlying profit before tax	39.1	26.1	43.5

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

Net interest margin

Net interest margin for the period was 1.69% (30 June 2022: 1.32%). The Bank of England Base Rate rises caused an increase in interest payable on customer deposits and higher wholesale funding costs. This was offset by a favourable variance on interest rate hedging instruments and liquid asset interest. This has resulted in a £136m increase in interest receivable and a £111m increase in interest payable.

Fair value movements

Fair value movements represent the change in value of certain assets and liabilities to reflect underlying market rates. These movements are primarily timing differences, which will reverse as the asset or liability approaches maturity. During the period, the group recognised a gain of £1.9m in the income statement (30 June 2022: £4.9m gain) in relation to these movements in fair value.

Operating expenses

Operating expenses increased when compared with the same period last year at £54.1m (30 June 2022: £45.3m). The main driver of the increase being the uplift in pay for all colleagues to assist with cost of living challenges causing an increase in staff costs of £6.7m. The remainder of the increase can be attributed to operational expenses including marketing and IT licenses. The reduction in the cost income ratio is due primarily to an increase in net interest income. Focus on managing the cost base of the Society as a proportion of assets remains a key strategic priority. The management expense ratio has remained largely flat since the end of last year and increased period to period for the reasons noted above.

Total operating expenses are set out in the table below:

	30 June 2023 £m	30 June 2022 £m	31 December 2022 £m
Retail financial services	52.2	43.7	96.6
Commercial lending	1.5	1.3	2.8
Secured personal lending	0.4	0.3	0.8
Total operating expenses	54.1	45.3	100.2
Management expense ratio[1]	0.95%	0.85%	0.90%
Cost income ratio[2]	55.37%	63.19%	62.67%

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

Impairment provisions for losses on loans and advances

The impairment provision movement over the first half of the year was a charge of £3.7m to £35.1m (30 June 2022: release of £0.2m to £17.6m). The group takes a conservative approach to lending and has robust affordability, credit quality and underwriting standards. The performance of the group's loan portfolios continues to be strong with the percentage of retail lending cases fully secured by a first charge with arrears greater than 3 months at 0.54% which compares favourably to the industry average of 0.87%[3]. However, management are required to incorporate forward-looking information into their calculation of expected credit losses, and the economic outlook has worsened given the cost of living crisis, higher inflation, higher interest rates and falling house prices. The net effect of these factors is that provisions have increased since 31 December 2022 (£31.9m).

While the group position has increased overall, there have been movements within the group's individual loan portfolios, as disclosed in the table overleaf. Each portfolio uses a different model to calculate provisions, which have different sensitivities to changes in the current and forecasted economic environment.

[3] UK Finance arrears and possession data as at May 2023.

Business review (continued)
for the six months ended 30 June 2023

Impairment provisions for losses on loans and advances (continued)

Total impairment provisions held are as follows:

	30 June 2023 £m	30 June 2022 £m	31 December 2022 £m
Retail mortgages	19.2	7.5	15.4
Secured personal lending	3.3	3.2	3.7
Commercial lending	12.6	6.9	12.8
Total	35.1	17.6	31.9

Total ECL coverage as at 30 June 2023 was 0.24% (2022: 0.22%) in respect of retail financial services and secured personal lending and 1.27% in respect of commercial lending (2022: 1.36%).

Statement of financial position

Total assets have increased to £11,625.5m (31 December 2022: £11,257.3m). An overall increase was anticipated as our retail mortgage portfolio has continued to grow. This is a result of our investment in IT, increasing our mortgage on-boarding capability and capacity to grow further. Our forward-looking strategy at year end was to continue our growth trajectory, maintaining a scalable organisation.

Loans and advances to customers

The retail mortgage portfolio increased to £8,699.2m (31 December 2022: £8,245.3m) with a net growth of £453.9m. The quality of the loans remains strong with an average balance to value of 53.48% (31 December 2022: 51.50%). The commercial lending portfolio also increased to £828.6m (31 December 2022: £762.0m), and the secured personal lending portfolio continued to run off, decreasing to £70.6m (31 December 2022: £80.1m).

Funding

Funding levels are closely monitored to maintain a diverse and balanced funding base. The majority of funding comes from retail savings, which has increased to £8,500.4m (31 December 2022: £8,113.6m) as a result of raising interest rates to attract more savings. Retail savings balances make up 80.57% of the total funding balance for the Society.

Capital and liquidity

The group's Common Equity Tier 1 ratio, which measures qualifying capital reserves as a proportion of risk weighted assets, is 24.85% as at 30 June 2022 (31 December 2022: 26.50%). This includes a PMA as a result of regulatory changes which came into effect on 1 January 2022. The model redevelopment is in an advanced stage with consultation ongoing with the PRA. The PMA applied is based on the expected capital requirement following model completion. The reduction is as a result of an increased level of risk in relation to certain loan assets as a result of the current economic outlook.

The PRA leverage ratio, a measure of Tier 1 capital held against total (non-risk-weighted) assets, including certain off-balance sheet commitments, is 6.20% at the end of the period (31 December 2022: 6.50%). The capital position remains robust and both ratios are well above the minimum regulatory requirements.

The business continues to hold a conservative buffer of high quality liquid assets, with a liquidity ratio of 16.78% (31 December 2022: 19.10%). The Liquidity Coverage Ratio (LCR) is 183.11% at 30 June 2023 (31 December 2022: 245.59%), which remains well above the current regulatory minimum of 100%. The LCR peaked at the end of 2022 following the issuance of a £350m RMBS, which increased the Society's liquid asset balance. This has since been used to fund mortgage growth, thereby reducing the ratio.

Business review (continued)
for the six months ended 30 June 2023

Principal risks and uncertainties

The principal risks and uncertainties affecting the group were set out in the Risk Overview section of the Strategic Report in the Annual Report and Accounts for the year ended 31 December 2022. These risks are categorised as: credit, market, liquidity and funding, conduct, operational, business, solvency and legal and regulatory risk, and are common to most financial services firms in the UK.

These remain the principal risks to the group at 30 June 2023.

The group continues to monitor the impact of rising interest rates and inflation on the macroeconomic environment, the performance of the group's lending portfolios and the availability of funding. The potential impact of rising interest rates and inflation is considered as part of impairment provisioning on page 24. This will continue to be closely monitored going forward.

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.

Iain Mansfield
Chief Financial Officer
4 August 2023

Condensed consolidated income statement
Group interim results for six months to 30 June 2023

	Notes	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Interest receivable and similar income	3	250.4	114.0	284.6
Interest payable and similar charges	4	(154.7)	(43.9)	(130.7)
Net interest income		95.7	70.1	153.9
Fees and commission receivable	5	1.8	1.7	3.9
Fees and commission payable		(1.3)	(1.0)	(2.2)
Net fee and commission income		0.5	0.7	1.7
Other operating income		0.6	0.5	3.1
Other fair value gains	6	1.9	4.9	5.8
Net operating income		98.7	76.2	164.5
Administrative expenses	7	(48.6)	(40.2)	(88.4)
Depreciation and amortisation		(5.5)	(5.1)	(10.5)
Other impairment losses		-	-	(1.3)
Operating expenses		(54.1)	(45.3)	(100.2)
Impairment credit for losses on loans and advances	14	(3.7)	0.2	(14.8)
Provisions for liabilities credit/(charges)	11	0.1	(0.1)	(0.2)
Operating profit and profit before taxation		41.0	31.0	49.3
Taxation expense	9	(9.6)	(6.8)	(11.6)
Profit for the period/year		31.4	24.2	37.7

Condensed consolidated statement of other comprehensive income
Group interim results for six months to 30 June 2023

	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Profit for the period/year	31.4	24.2	37.7
Items that will not be reclassified subsequently to profit and loss:			
Actuarial (loss)/gain on retirement benefit obligations	(1.1)	2.9	(4.2)
Tax on retirement benefit obligations	0.2	(0.7)	1.0
Items that may be reclassified subsequently to profit and loss:			
Gain/(loss) on assets at fair value through other comprehensive income	0.8	(1.7)	(2.8)
Tax on assets at fair value through other comprehensive income	(0.2)	0.4	0.7
Total comprehensive income for the period/year	31.1	25.1	32.4

Condensed consolidated statement of financial position
Group interim results as at 30 June 2023

	Notes	30 June 2023 £m (Unaudited)	30 June 2022 £m (Unaudited)	31 December 2022 £m (Audited)
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		1,258.2	1,121.2	1,566.9
Loans and advances to credit institutions		264.9	153.3	277.1
Debt securities		293.1	134.3	160.2
		1,816.2	1,408.8	2,004.2
Derivative financial instruments		492.1	189.8	369.0
Loans and advances to customers:				
Loans fully secured on residential property		8,925.2	8,573.5	8,495.7
Other loans		305.9	276.2	299.2
	10	9,231.1	8,849.7	8,795.0
Current tax assets		8.0	-	6.3
Intangible fixed assets		21.2	25.5	23.5
Property, plant and equipment		35.5	39.3	36.3
Investment properties		5.8	6.1	5.8
Deferred tax assets		3.0	2.3	2.9
Other assets		1.8	1.7	0.5
Retirement benefit obligations	8	-	6.1	-
Prepayments and accrued income		10.8	9.9	13.8
Total assets		11,625.5	10,539.2	11,257.3
Liabilities				
Shares		8,500.5	7,934.6	8,113.6
Deposits and debt securities:				
Amounts owed to credit institutions		1,640.6	1,163.8	1,639.0
Amounts owed to other customers		206.3	207.5	255.0
Debt securities in issue		448.7	502.3	467.2
		2,295.6	1,873.6	2,361.2
Derivative financial instruments		85.4	29.2	63.6
Current tax liabilities		-	0.1	-
Other liabilities		8.4	11.6	13.7
Provisions for liabilities	11	2.6	2.7	2.8
Accruals and deferred income		8.2	7.7	10.9
Deferred tax liabilities		12.9	8.3	11.8
Retirement benefit obligations	8	2.0	-	0.9
Total liabilities		10,915.6	9,867.8	10,578.5
General reserve		710.6	671.9	680.1
Other reserves		(0.7)	(0.5)	(1.3)
Total equity and liabilities		11,625.5	10,539.2	11,257.3

Condensed consolidated statement of changes in Members' interests
Group interim results for six months to 30 June 2023

	Six months to 30 June 2023 (Unaudited)		
	General Reserve £m	Fair Value through OCI reserve £m	Total equity attributable to Members £m
Balance at 1 January 2023	680.1	(1.3)	678.8
Comprehensive income/(expense) for the period	30.5	0.6	31.1
At 30 June 2023	710.6	(0.7)	709.9

	Six months to 30 June 2022 (Unaudited)		
	General Reserve £m	Fair Value through OCI reserve £m	Total equity attributable to Members £m
At 1 January 2022	645.5	0.8	646.3
Comprehensive income/(expense) for the period	26.4	(1.3)	25.1
At 30 June 2022	671.9	(0.5)	671.4

	Year to 31 December 2022 (Audited)		
	General Reserve £m	Fair Value through OCI reserve £m	Total equity attributable to Members £m
At 1 January 2022	645.5	0.8	646.3
Comprehensive income/(expense) for the period	34.6	(2.1)	32.5
At 31 December 2022	680.1	(1.3)	678.8

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 2023

	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Net cash flows from operating activities	(156.3)	(277.4)	(129.4)
Cash flows from investing activities			
Purchase of intangible assets	-	(1.6)	(1.5)
Purchase of property, plant and equipment	(2.3)	(5.6)	(6.3)
Purchase of investment securities	(79.4)	(62.3)	(107.6)
Proceeds from sale and maturity of investment securities	(52.2)	2.6	20.9
Net cash flows from investing activities	**(133.9)**	**(66.9)**	**(94.5)**
Cash flows from financing activities			
Interest paid on debt securities in issue	(7.9)	(5.5)	(12.0)
Proceeds from issuance of debt securities in issue	0.4	0.6	489.6
Redemption of debt securities in issue	(22.7)	(187.4)	(220.3)
Repayments of lease liabilities	(0.5)	(0.5)	(1.0)
Net cash flows from financing activities	**(30.7)**	**(192.8)**	**256.3**
(Decrease)/increase in cash and cash equivalents	(320.9)	(537.1)	32.4
Cash and cash equivalents at beginning of period/year	1,844.0	1,811.6	1,811.6
Cash and cash equivalents at end of period/year	**1,523.1**	**1,274.5**	**1,844.0**
Represented by:			
Cash and balances with the Bank of England	1,258.2	1,121.2	1,566.9
Loans and advances to credit institutions repayable on demand	264.9	153.3	277.1
	1,523.1	1,274.5	1,844.0
Operating activities			
Profit before taxation	41.0	31.0	49.3
Adjusted for:			
Depreciation and amortisation	5.5	5.1	10.5
Charge on defined benefit pension scheme	-	-	(0.1)
Impairment on loans and advances to customers	3.7	(0.2)	14.8
Impairment on fixed assets	-	-	0.4
Change in fair values	70.1	118.4	239.5
Change in other provisions	(0.4)	0.1	0.1
Interest on debt securities in issue	8.0	5.5	16.1
Other non-cash items included in profit before tax	(0.6)	(0.2)	(0.1)
Changes in net operating assets			
Loans and advances to customers	(518.8)	(94.5)	(180.2)
Other operating assets	1.7	(0.4)	(4.7)
Derivative financial instruments	(101.2)	(132.6)	(277.4)
Shares	399.4	(5.8)	175.2
Deposits	(47.1)	(195.1)	(165.2)
Other operating liabilities	(7.3)	(2.1)	3.6
Taxation paid	(10.3)	(6.6)	(11.2)
Net cash flows from operating activities	**(156.3)**	**(277.4)**	**(129.4)**

Notes to the accounts
for the six months ended 30 June 2023

1. Basis of preparation

The condensed consolidated set of financial statements of the group for the half-year ended 30 June 2023 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. The annual financial statements of the group are prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted for use within the UK. The accounting policies adopted are consistent with those of the previous financial year.

Going concern

The Directors have assessed the viability of the group, taking into account business strategy, principal risks and current economic conditions. The approach taken is consistent with that undertaken at the 2022 year-end.

The Directors have considered the resilience of the group, taking account of its current position, the risks facing the business in severe but plausible scenarios and the effectiveness of any mitigating actions. The assessment has considered the potential impacts on the business model, future performance, capital adequacy and liquidity. The group's financial forecasts have been refreshed and take consideration of the expected impact of rising interest rates, high inflation and the Russia-Ukraine conflict on the macroeconomic environment, the performance of the group's lending portfolios and the availability of funding.

The group's most recent Internal Capital Adequacy Assessment Process (ICAAP) has recently been finalised and the Internal Liquidity Adequacy Assessment Process (ILAAP) is due to be approved imminently. Both are completed annually and use internal scenarios aligned to the Bank of England severity benchmarks and 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, inflation and reduced funding availability within wholesale and retail markets.

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

New and amended standards adopted by the group

Amendments to IFRS 17 have been adpoted in the year with a mandatory effective date of 1 January 2023. Adoption of the amendments did not have any impact on the group's accounting policies and did not require retrospective adjustments.

There were no other new or amended standards adopted in the current year.

Impact of standards issued but not yet applied

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

Notes to the accounts
for the six months ended 30 June 2023

1. Basis of preparation (continued)

Mortgage control accounts

Consistent with our accounting policies applied at year-end we have re-presented a prior period (June-22) control account relating to commercial mortgages with a balance of £4.2m from other assets to loans and advances to customers.

Judgements in applying accounting policies and critical accounting estimates

The critical judgements and areas of critical accounting estimates remain consistent with those disclosed in the 2022 Annual Report and Accounts. This relates to impairment provisions on loans and advances (note 14, pages 22-27) and retirement benefit obligations (note 8, page 17), where sensitivity analysis has been performed and key judgements are reviewed.

2. Business segments

The group operates three 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 2023 (Unaudited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	80.5	12.3	2.9	95.7
Other income and charges	0.4	0.7	-	1.1
Fair value gain	1.9	-	-	1.9
Net operating income	82.8	13.0	2.9	98.7
Operating expenses	(52.2)	(1.5)	(0.4)	(54.1)
Impairment provision for losses on loans and advances	(3.7)	0.2	(0.2)	(3.7)
Provision for other liabilities and charges	-	-	0.1	0.1
Operating profit and profit before taxation	26.9	11.7	2.4	41.0
Taxation expense				(9.6)
Profit after taxation				31.4

	Six months to 30 June 2022 (Unaudited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	58.5	7.7	3.9	70.1
Other income and charges	0.6	0.6	-	1.2
Fair value gain	4.9	-	-	4.9
Net operating income	64.0	8.3	3.9	76.2
Operating expenses	(43.7)	(1.3)	(0.3)	(45.3)
Impairment provision for losses on loans and advances	0.9	(0.4)	(0.3)	0.2
Provision for other liabilities and charges	-	-	(0.1)	(0.1)
Operating (loss)/profit and loss before taxation	21.2	6.6	3.2	31.0
Taxation credit				(6.8)
Profit after taxation				24.2

Notes to the accounts
for the six months ended 30 June 2023

2. Business segments (continued)

	Year ended 31 December 2022 (Audited)			
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Total £m
Net interest income	128.8	17.8	7.3	153.9
Other income and charges	3.3	1.5	-	4.8
Fair value gain	5.8	-	-	5.8
Net operating income	137.9	19.3	7.3	164.5
Operating expenses	(96.6)	(2.8)	(0.8)	(100.2)
Impairment provision for losses on loans and advances	(7.7)	(6.3)	(0.8)	(14.8)
Provision for liabilities	0.1	-	(0.3)	(0.2)
Operating profit and profit before taxation	33.7	10.2	5.4	49.3
Taxation expense				(11.6)
Profit after taxation				37.7

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

	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Total assets by business segments			
Retail financial services	10,744.4	9,643.3	10,436.5
Secured personal lending	83.5	127.0	82.0
Commercial lending	797.6	768.9	738.8
Total assets	11,625.5	10,539.2	11,257.3
Total liabilities and equity by business segment			
Retail financial services and Commercial lending	11,542.0	10,412.2	11,175.3
Secured personal lending	83.5	127.0	82.0
Total liabilities and equity	11,625.5	10,539.2	11,257.3

3. Interest receivable and similar income

	Group		
	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
On loans fully secured on residential property	133.9	103.9	219.8
On other loans	11.4	5.2	10.6
On debt securities	3.9	0.5	2.1
On other liquid assets	31.7	4.6	21.6
On derivative financial instruments	69.5	(0.2)	30.5
	250.4	114.0	284.6

Notes to the accounts
for the six months ended 30 June 2023

4. Interest payable and similar charges

	Group		
	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
On shares held by individuals	99.3	31.7	89.6
On deposits and debt securities	45.3	11.1	36.7
On lease liabilities	0.1	0.2	0.3
On derivative financial instruments	10.0	0.9	4.1
	154.7	43.9	130.7

5. Fees and commission receivable

	Group		
	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Insurance and related financial service products	0.4	0.4	0.7
Mortgage related fees	1.4	1.3	3.2
	1.8	1.7	3.9

6. Other fair value gains and losses

	Group		
	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Gains on derivatives in hedging relationships	70.2	124.9	245.1
Gains/(losses) on derivatives not in hedging relationships	1.8	(1.6)	0.2
Gains on derivatives	72.0	123.3	245.3
Gains/(losses) on economic hedged items	5.3	(1.2)	(6.0)
(Losses) on hedged items attributable to hedged risk	(75.4)	(117.2)	(233.5)
(Losses) on hedged items	(70.1)	(118.4)	(239.5)
	1.9	4.9	5.8

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

Notes to the accounts
for the six months ended 30 June 2023

7. Administrative expenses

	Group		
	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Wages and salaries	25.0	21.1	45.5
Social security costs	2.3	2.0	4.1
Other pension costs	1.5	1.2	2.6
	28.8	24.3	52.2
Other administrative expenses	19.8	15.9	36.2
	48.6	40.2	88.4

Staff costs have increased when compared to the same period last year as a result of the uplift in pay for all colleagues to assist with cost of living challenges. Other adminstrative expenses have also seen an increase as a result of increased marketing and IT costs.

8. Retirement benefit obligations

	Group		
	30 June 2023 £m (Unaudited)	30 June 2022 £m (Unaudited)	31 December 2022 £m (Audited)
Fair value of plan assets	46.5	64.7	49.6
Present value of funded and unfunded obligations	(48.5)	(58.6)	(50.5)
Pension scheme surplus	(2.0)	6.1	(0.9)

The pension scheme deficit has increased from £0.9m at December 2022 to £2.0m at 30 June 2023, primarily as a result of actuarial losses of £1.1m 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	(3.1)	3.1
Inflation	2.6	(2.6)
Life expectancy (+1 year/ -1 year)	1.3	(1.3)

Notes to the accounts
for the six months ended 30 June 2023

9. Taxation

Taxation for the group for the 6 months to 30 June 2023 is charged at 23.4% (30 June 2022: 21.9%), 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 corporation tax for the year ending December 2022 was 23.5%. On 1st April 2023, the corporation tax rate increased from 19% to 25%, this is reflected in the blended tax rate of 23.5% applied in the table below. The banking surcharge rate reduced to 3% and is now applied to profits over £100m (previously 8% over £25m). The June 2023 and December 2022 tax charges include the banking surcharge due to annual and estimated annual profits being above £25m.

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 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Profit before tax	41.0	31.0	49.3
Profit multiplied by the blended standard rate of corporation tax at 23.50% (2022: 19.00%)	9.6	5.9	9.4
Effects of:			
Expenses not deductible for tax purposes	(0.2)	(0.2)	0.9
Adjustments to prior years	-	-	(0.4)
Impact of banking surcharge	0.3	0.5	-
Impact of rate change	0.2	-	1.7
Timing differences	(0.3)	0.6	-
Tax charge	9.6	6.8	11.6

10. Loans and advances to customers

	Group		
	30 June 2023 £m (Unaudited)	30 June 2022 £m (Unaudited)	31 December 2022 £m (Audited)
Fully secured on residential property	9,314.5	8,740.3	8,803.4
Fully secured on land	305.9	276.2	299.2
	9,620.4	9,016.5	9,102.6
Provision for impairment losses	(35.1)	(17.6)	(31.9)
Unamortised loan origination fees	13.1	13.8	12.7
Fair value adjustment for hedged risk	(367.3)	(163.0)	(288.4)
	9,231.1	8,849.7	8,795.0

Notes to the accounts
for the six months ended 30 June 2023

11. Provisions for liabilities

	Group		
	30 June 2023 £m (Unaudited)	30 June 2022 £m (Unaudited)	31 December 2022 £m (Audited)
At beginning of the period/year	2.8	2.7	2.7
Charge for the period/year	0.1	0.1	(0.2)
Release during the period/year	(0.3)	(0.1)	0.3
At end of the period/year	2.6	2.7	2.8

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

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

12. Related party transactions

The group had no related party transactions outside the normal course of the business during the six months to 30 June 2023. Transactions for this period are similar to those for the year to 31 December 2022, details of which can be found in note 33 of the 2022 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 2023		31 December 2022	
	Carrying Value £m (Unaudited)	Fair Value £m (Unaudited)	Carrying Value £m (Audited)	Fair Value £m (Audited)
Total assets				
Cash in hand and balances with Bank of England	1,258.2	1,258.2	1,566.9	1,566.9
Loans and advances to credit institutions	264.9	272.4	277.1	284.6
Debt securities	293.1	293.1	160.2	160.2
Derivative financial instruments	492.1	492.1	369.0	369.0
Loans and advances to customers	9,231.1	9,284.7	8,795.0	8,838.4
	11,539.4	11,600.5	11,168.2	11,219.1
Total liabilities				
Shares	8,500.5	8,556.9	8,113.6	8,173.4
Amounts owed to credit institutions	1,640.6	1,640.6	1,639.0	1,638.9
Amounts owed to other customers	206.3	206.3	255.0	255.0
Debt securities in issue	448.7	444.1	467.2	459.4
Derivative financial instruments	85.4	85.4	63.6	63.6
	10,881.5	10,933.3	10,538.4	10,590.3

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for the six months ended 30 June 2023

13. Financial instruments (continued)

Further details on the methods and assumptions which have been applied in determining fair value are set out in note 30 of the 2022 Annual Report and Accounts.

Assets and liabilities measured at fair value

	30 June 2023 (Unaudited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	492.1	-	448.0	44.1
Financial assets at fair value through other comprehensive income:				
Debt securities	293.1	293.1	-	-
Total	785.2	293.1	448.0	44.1
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	-	1.9	-
Debt securities in issue	(7.1)	(7.1)	-	-
Derivative financial instruments	85.4	-	41.3	44.1
Total	80.2	(7.1)	43.2	44.1

	30 June 2022 (Unaudited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	189.8	-	177.4	12.4
Financial assets at fair value through other comprehensive income:				
Debt securities	134.3	134.3	-	-
Total	324.1	134.3	177.4	12.4
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	-	1.9	-
Debt securities in issue	(8.4)	(8.4)	-	-
Derivative financial instruments	29.2	-	16.8	12.4
Total	22.7	(8.4)	18.7	12.4

	31 December 2022 (Audited)			
	£m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	369.0	-	333.4	35.6
Financial assets at fair value through other comprehensive income:				
Debt securities	160.2	160.2	-	-
Total	529.2	160.2	333.4	35.6
Financial liabilities at fair value through profit or loss:				
Amounts owed to credit institutions	1.9	-	1.9	-
Debt securities in issue	(10.8)	(10.8)	-	-
Derivative financial instruments	63.6	-	27.9	35.7
Total	54.7	(10.8)	29.8	35.7

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 2023

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. There were no significant inter-relationships between unobservable inputs that materially affect fair values.

The fair value of the level 3 derivatives is shown in the table below.

	Group		
	30 June 2023 £m (Unaudited)	30 June 2022 £m (Unaudited)	31 December 2022 £m (Audited)
Financial assets at fair value through profit or loss:			
At beginning of the period/year	35.7	3.6	3.6
Fair value gains/(losses)	6.1	9.1	29.2
Interest (paid)/received	251.3	(0.3)	2.9
At end of the period/year	293.1	12.4	35.7
Financial liabilities at fair value through profit or loss:			
At beginning of the period/year	(35.7)	(3.6)	(3.6)
Fair value losses/(gains)	(6.1)	(9.1)	(29.2)
Interest (received)/paid	(251.3)	0.3	(2.9)
At end of the period/year	(293.1)	(12.4)	(35.7)

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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 2023 £m (Unaudited)	30 June 2022 £m (Unaudited)	31 December 2022 £m (Audited)
In respect of loans and advances to customers:			
Secured by a first charge on residential property	9,241.6	8,645.3	8,720.9
Secured by a first charge on land	305.9	276.3	299.3
Secured by a second charge on residential property	72.9	94.9	82.5
	9,620.4	9,016.5	9,102.7
Provisions for impairment losses	(35.1)	(17.6)	(31.9)
Effective interest rate adjustments	13.1	13.8	12.7
Fair value adjustments	(367.3)	(163.0)	(288.5)
	9,231.1	8,849.7	8,795.0

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 2023 £m (Unaudited)	31 December 2022 £m (Audited)	30 June 2023 £m (Unaudited)	31 December 2022 £m (Audited)	30 June 2023 £m (Unaudited)	31 December 2022 £m (Audited)
1	7,561.6	7,135.6	857.0	840.9	32.1	35.5
2	1,842.6	1,524.3	126.9	97.7	31.8	36.3
3	55.3	48.2	5.6	6.7	8.7	10.3
	9,459.5	8,708.1	989.5	945.3	72.6	82.1

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 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
Retail financial services	19.2	7.5	15.4
Secured personal lending	3.3	3.2	3.7
Commercial lending	12.6	6.9	12.8
	35.1	17.6	31.9

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14. Credit risk (continued)

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

Retail Financial Services and Secured Personal Lending

Stage	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
1	79.6%	82.4%	81.6%
2	19.7%	16.9%	17.7%
3	0.7%	0.7%	0.7%
	100.0%	100.0%	100.0%

Commercial Lending

Stage	6 months to 30 June 2023 £m (Unaudited)	6 months to 30 June 2022 £m (Unaudited)	Year ended 31 December 2022 £m (Audited)
1	86.6%	90.8%	89.0%
2	12.8%	8.2%	10.3%
3	0.6%	1.0%	0.7%
	100.0%	100.0%	100.0%

The average index-linked loan balance to value (BTV), in respect of the group's loans secured by a first or second charge on residential property, is 53.5% (31 December 2022: 51.5%).

The percentage of retail lending cases fully secured by a first charge, currently with arrears greater than three months is 0.54% (31 December 2022: 0.53%).

Residential lending cases fully secured by a first charge which were six months or more in arrears had arrears balances of £1.3m (31 December 2022: £1.2m) with 217 (31 December 2022: 208) cases.

The percentage of secured personal loans currently in arrears by two months or more by number is 8.31% (31 December 2022: 10.23%), which by value is 11.14% (31 December 2022: 11.88%).

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.

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14. Credit risk (continued)

Sensitivity analysis has been performed on the staging criteria. 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 a 10% increase or reduction in the volume of loans in stage 2 is as follows:

Stage	Retail financial services £m	Secured personal lending £m	Commercial lending £m
Stage 1 to Stage 2	3.9	0.1	3.6
Stage 2 to Stage 1	(1.0)	-	(0.4)

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 incumbent downside scenario was replaced with a stagflation scenario in the prior year. This scenario assumes that the conflict in Ukraine lasts longer than in the baseline leading to a slower decline in inflation and higher interest rates.

Scenario	Weighting at 30 June 2023 %	2023 Scenario				Weighting at 31 Dec 2022 %	2022 Scenario			
		2023 %	2024 %	2025 %	2026 %		2023 %	2024 %	2025 %	2026 %
HPI (Growth)										
Base	50	(4.9)	1.0	4.7	2.9	50	(4.4)	2.3	4.8	2.9
Upside	20	1.1	11.0	4.6	(1.1)	20	9.0	5.4	2.1	(1.2)
Downside	23	(8.4)	(13.9)	(4.6)	4.1	23	(14.5)	(12.0)	1.9	5.5
Severe Downside	7	(11.3)	(18.1)	(0.9)	4.0	7	(20.7)	(10.9)	4.4	4.3

Scenario	Weighting at 30 June 2023 %	2023 Scenario				Weighting at 31 Dec 2022 %	2022 Scenario			
		2023 %	2024 %	2025 %	2026 %		2023 %	2024 %	2025 %	2026 %
Unemployment (Absolute)										
Base	50	4.3	4.5	4.5	4.6	50	4.3	4.5	4.5	4.6
Upside	20	3.9	3.8	3.7	3.8	20	3.9	3.6	3.7	4.0
Downside	23	4.6	6.7	7.0	7.0	23	5.6	7.0	7.0	6.9
Severe Downside	7	5.4	8.5	8.2	8.1	7	7.4	8.3	8.2	7.9

Scenario	Weighting at 30 June 2023 %	2023 Scenario				Weighting at 31 Dec 2022 %	2022 Scenario			
		2023 %	2024 %	2025 %	2026 %		2023 %	2024 %	2025 %	2026 %
GDP (Growth)										
Base	50	3.3	3.4	3.5	2.9	50	2.8	3.4	2.5	2.3
Upside	20	5.2	5.0	3.5	2.8	20	5.3	3.1	2.1	2.3
Downside	23	3.0	3.7	0.3	2.0	23	3.2	2.1	(1.2)	3.6
Severe Downside	7	(3.6)	(6.6)	4.6	4.7	7	(10.9)	(0.3)	4.1	2.8

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14. Credit risk (continued)

Post model adjustment - Refinance risk

The increase in the Bank of England base rate and impact on mortgage pricing is going to place additional affordability pressures on customers due to refinance within the next 60 months. With price inflation significantly higher than wage inflation certain customers may struggle to afford their mortgage repayments when their rate resets. In order to address this risk a group of 4,026 customers, based on credible evidence that they may be unable to afford their mortgage payments when they refinance and their payments increase, are deemed most at risk has been identified. A Post Model Adjustment (PMA) of £2.9m has been applied (31 December: £2.9m). Reducing the refinance period from 60 months to 18 months would reduce the PMA by £2.1m to £0.8m. In December 2022, the refinance period applied was 12 months with 887 customers identified. The refinance period has been extended to 60 months in line with the current maximum fixed term period.

Post model adjustment - Cost of living

The record levels of inflation seen over the past 18 months has resulted in significant cost of living pressures. These pressures are expected to continue and there is a risk that this will result in increased levels of arrears and defaults that are not captured by the model. In response to this challenge data has been obtained from an external third party to estimate the potential impact on the retail portfolio. This data has indicated that a group of 3,860 customers may be adversely impacted by key affordability metrics including food and fuel inflation (31 December: 5,326). The reduction in volume of accounts captured relates to the reduction in the energy price cap. In order to capture the risk in relation to this group a PMA of £1.2m has been applied (31 December: £1.5m). The PMA is based on customers meeting three or more affordability indicators. Reducing to two indicators will increase the PMA by £3.5m, increasing to four indicators will reduce the PMA by £0.9m.

Post model adjustment - Industry weightings alignment

The governance and review of economic data used within the IFRS 9 models includes a peer benchmarking exercise, whilst the economic forecasts benchmark consistently with peers the peer benchmarking identified an element of optimism within the weightings used. In order to ensure a closer allignment to peers a PMA of £3.0m (31 December 2022: £2.5m) has been applied across all three portfolios based on the impact of recalculating modelled provisions using industry average weightings. The increase is driven by an increase in the level of weightings applied to downturn scenarios from 30% to 40%.

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

Portfolio	Upside £m	Severe Downside £m	ECL Range £m
Retail financial services	4.1	28.8	24.7
Secured personal lending	1.6	4.1	2.5
Commercial lending	6.0	8.7	2.7
Total	**11.7**	**41.6**	**29.9**

Notes to the accounts
for the six months ended 30 June 2023

14. Credit risk (continued)

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

	Group			
	Stage 1 12 month ECL £m	Stage 2 Lifetime ECL £m	Stage 3 Lifetime ECL £m	Total £m
At 1 January 2023	14.5	11.3	6.1	31.9
Transfers:				
Stage 1 transfers	(6.7)	-	-	(6.7)
Stage 2 transfers	-	5.6	-	5.6
Stage 3 transfers	-	-	1.0	1.0
New loans	2.3	0.2	0.1	2.6
Settled loans	(1.0)	(0.4)	(0.2)	(1.6)
Utilisation of provisions	-	-	(0.6)	(0.6)
Changes in credit quality	3.9	(1.2)	0.1	2.8
Changes in loan model assumptions	(0.3)	0.2	0.2	0.1
Loss allowance at 30 June 2023	12.7	15.7	6.7	35.1

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

ii) Commercial

Loans secured on commercial property are diversified by industry type with the largest exposure to one counterparty amounting to £56.1m (31 December 2022: £26.0m) or 6.6% (31 December 2022: 3.4%) of gross balances.

Asset quality remains strong with impaired balances of £4.8m (31 December 2022: £9.3m), or 0.6% of gross balances (31 December 2022: 1.2%).

The sharp rise in interest rates has seen some Commercial Lending customers fall into forbearance due to interest cover covenant (ICC) breaches although none are currently in arrears. The number of accounts in forebearance has increased to 207 with balances of £237.5m (December 2022: 160 accounts with balances of £175.5m).

Notes to the accounts
for the six months ended 30 June 2023

14. Credit risk (continued)

iii) Treasury

The treasury risk function monitors exposure concentrations against a variety of criteria including counterparty and country limits, and all exposures are well spread across this risk assessment framework. Provisions for expected credit losses in relation to treasury instruments of £1.4m were held at 30 June 2023 (31 December 2022: £1.6m).

15. Post Balance Sheet and Subsequent Events

On the 12th July the Society issued £300m of Senior Unsecured bonds into the market in order to refinance the previous unsecured issuance due to redeem in November 2023.

Responsibility statement

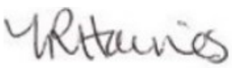
We confirm that to the best of our knowledge:

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

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

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

By order of the Board,



Julie-Ann Haines
Chief Executive Officer
4 August 2023

Independent review report to Principality Building Society

We have been engaged by the Principality Building Society to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2023 which comprises the condensed consolidated income statement, condensed consolidated statement of other comprehensive income, condensed consolidated statement of financial position, condensed statement of changes in Member's interests, condensed consolidated statement of cash flows and related notes 1 to 15.

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 2023 is not prepared, in all material respects, in accordance with United Kingdom adopted International Accounting Standard 34 and the Disclosure Guidance and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Basis for Conclusion

We conducted our review in accordance with International Standard on Review Engagements (UK) 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 (ISRE (UK) 2410). 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.

As disclosed in note 1, the annual financial statements of the Society are prepared in accordance with United Kingdom adopted international accounting standards. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with United Kingdom adopted International Accounting Standard 34, "Interim Financial Reporting".

Conclusion Relating to Going Concern

Based on our review procedures, which are less extensive than those performed in an audit as described in the Basis for Conclusion section of this report, nothing has come to our attention to suggest that the directors have inappropriately adopted the going concern basis of accounting or that the directors have identified material uncertainties relating to going concern that are not appropriately disclosed.

This Conclusion is based on the review procedures performed in accordance with ISRE (UK) 2410; however future events or conditions may cause the entity to cease to continue as a going concern.

Responsibilities of 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.

In preparing the half-yearly financial report, the directors are responsible for assessing 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 Society or to cease operations, or have no realistic alternative but to do so.

Auditor’s Responsibilities for the review of the financial information

In reviewing the half-yearly financial report, we are responsible for expressing to the Society a conclusion on the condensed set of financial statements in the half-yearly financial report. Our Conclusion, including our Conclusion Relating to Going Concern, are based on procedures that are less extensive than audit procedures, as described in the Basis for Conclusion paragraph of this report.

Independent review report to Principality Building Society (continued)

Use of our report

This report is made solely to the Society in accordance with ISRE (UK) 2410. 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.

Deloitte LLP

Deloitte LLP
Statutory Auditor
Cardiff, UK
4 August 2023

Other information

The information for the period ended 30 June 2023 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 2022 has been extracted from the Annual Report and Accounts for that year. The annual accounts for the year ended 31 December 2022 have been filed with the Financial Conduct Authority.

The auditor's report on the 2022 Annual Report and Accounts was not qualified and did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report.

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

Glossary

Arrears	A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan payment is overdue. Such a customer can also be said to be in a state of delinquency.
Brand consideration	Brand consideration measures whether a respondent would actively consider Principality the next time they take out a financial product or service.
Carbon Net Zero	Net zero means that we will reduce all of our scope 1 and 2 emissions to as little as possible by 2030 as well as the following elements of our scope 3 emissions: paper, water, external data centres, waste disposal, business travel, colleague commuting and home working. We will neutralise residual emissions with net zero aligned carbon removals. Scope 1 emissions - generated by directly owned or controlled sources i.e. fuel combustion and company-owned vehicles. Scope 2 emissions - purchased electricity. Scope 3 emissions - other indirect operational emissions that occur in the supply chain, both upstream and downstream.
Commercial lending	loans to a commercial borrower.
Contractual maturity	The final payment date of a loan or other financial instrument, at which point the entire remaining outstanding principal and interest is due to be repaid.
Common Equity Tier 1 capital	The highest quality form of capital as defined in the Capital Requirements Directive IV, comprising accumulated reserves and qualifying instruments after regulatory deductions.
Common Equity Tier 1 capital ratio	Common Equity Tier 1 capital as a proportion of risk-weighted assets.
Cost income ratio	A ratio that represents the proportion of management expenses (i.e. administrative expenses, depreciation and amortisation) to total income.
Credit risk	The risk of financial loss arising from a failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.
Debt securities in issue	Transferable certificates of indebtedness including certificates of deposits, and fixed and floating rate notes.
Defined benefit pension scheme	A scheme that defines the benefit an employee will receive on retirement, depending on such factors as age, length of service and salary.
Financial Conduct Authority (FCA)	The statutory body responsible for conduct of business regulation and supervision of UK authorised firms from 1 April 2013. The FCA also has responsibility for protecting consumers and promoting healthy competition.
Internal Capital Adequacy Assessment Process (ICAAP)	The group's internal assessment of the levels of capital that need to be held by the Society to meet its regulatory capital requirements.
Internal Liquidity Adequacy Assessment Process (ILAAP)	The group's internal assessment of the levels of liquidity that need to be held by the Society to meet its regulatory liquidity requirements.
Leverage ratio	A ratio which measures Tier 1 capital against total on and off balance sheet assets.
Liquid assets	Cash or other assets that can be readily converted to cash without loss of value.

Glossary (continued)

Liquidity Coverage Ratio (LCR)	A liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30 calendar day time horizon under a severe stress scenario.
Loan To Value ratio (LTV)	A ratio showing outstanding loan balance as a percentage of the value of the security.
Management expense ratio	A ratio that measures cost as a proportion of mean assets.
Member	A person who has a share investment or a mortgage loan with the Society.
Net interest income	The difference between the interest received on assets and the interest paid on liabilities.
Net interest margin	This ratio calculates the net interest income as a percentage of mean total assets.
Net retail mortgage lending	Total movements in the retail mortgage book; includes all inflows and outflows in respect of retail lending.
Net retail savings growth	Total movements in the retail savings portfolio; includes all inflows and outflows in relation to retail savings.
Permanent Interest-Bearing Shares (PIBS)	Unsecured, Sterling denominated Additional Common Equity Tier 1 capital instruments repayable at the option of the Society.
Regulatory capital	Capital allowable under regulatory rules, less certain required regulatory adjustments and deductions.
Residential Mortgage Backed Securities (RMBS)	A category of asset backed security that represents interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).
Retail loans	Loans to individuals rather than institutions, including residential mortgage lending.
Shares	Money deposited by Members in a retail savings account with the Society and held as a liability in the statement of financial position.
Subscribed capital	See Permanent Interest-Bearing Shares (PIBS).

ONLINE

Visit us at **principality.co.uk**
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including our opening hours.

VISIT

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

CONTACT

If you would like to get in touch
call us on **0330 333 4000**• or email
us at **enquiries@principality.co.uk**

MEMBER PULSE

Have your say by joining
our online community at
principalitypulse.co.uk

Building your future

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

HYFS 08/23-1

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