PRINCIPALITY BUILDING SOCIETY | 150 YEARS at the heart of Wales

Annual Report and Accounts for the year ended 31 December 2009

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This brochure is available in large print, braille and audio tape.

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Chairman's statement

In a year of continued turbulent economic conditions your Society has delivered a robust operating performance in 2009. Although the financial system is now more stable than twelve months ago, the year was characterised by the move to near-zero interest rates, an ongoing recession and low levels of consumer confidence, all of which affect every aspect of our business.

We have been faced with higher cost of funds and higher provisions as a direct consequence of the credit crisis and recession. Despite this very difficult economic environment our pre-tax profit was a very creditable £14.3m compared with £9.3m last year.

Staff at our Queeen Street branch in 1933

Risk management focus

We have continued to place strong emphasis on robust risk management throughout the Group. During the year our Group Risk Committee was reconstituted as a Board Committee and Christopher Rowlands became Group Risk Committee Chairman.

Keith Brooks, another non-executive director, also became a member of the Committee. We have also appointed a Director of Risk who now reports directly to the Board and leads a centralised and strengthened Group risk function.

We continue to attach the highest importance to the fair treatment of all our Members and the Board regularly reviews a range of measures to monitor this. Although our Society mortgage arrears remain below the average for the sector, in the current difficult economic climate we have paid particular attention to ensuring that all forbearance options are considered for those borrowers experiencing difficulties with their repayments. The Group has maintained adequate provisions against the risk of losses on its loans to customers. Keeping our Members' money safe during these testing times remains our number one priority.

Corporate governance and regulatory expectations

We have taken careful account of the recommendations in the report of Sir David Walker into corporate governance in UK banks and other financial entities. Although not specifically addressed to all building societies, these recommendations will undoubtedly become generally accepted as best practice which, where relevant to our business, we are committed to follow.

In conjunction with the Remuneration Committee, the Board has addressed the Policy Statement and Code of Practice published by the Financial Services Authority in relation to remuneration. Our remuneration policies remain closely aligned with regulatory expectations.

In June, the Financial Services Authority published a major Consultation Paper which proposed the introduction in 2010 of enhanced supervisory guidance for building societies in relation to treasury and credit risk management. We are confident we can fulfil the regulator's requirements and the necessary preparations are well advanced.

Board and management

I am pleased to welcome three new non-executive directors who joined the Board in 2009: Jo Kenrick brings much expertise from the retail sector having most recently been Marketing Director for B&Q plc; Christopher Rowlands, who rejoined the Board at the conclusion of a two-year appointment overseas with 3i plc; and Dyfrig John, who retired during the year as Deputy Chairman and Chief Executive of HSBC Bank plc. As a mutual society, it is essential that our Board has the wide set of skills needed to support our business strategy as well as to scrutinise and challenge our thinking. All three new members have an impressive track record and have already made extremely valuable contributions to the Board's discussions.

On this occasion I would like to make special mention of Eurfyl ap Gwilym, our Deputy Chairman, who will be retiring at the forthcoming Annual General Meeting. I am personally grateful to Eurfyl for his support as Deputy Chairman and we all acknowledge and thank him for the significant contribution he has made to the Board and the Society as a non-executive director over the past nine years. His counsel on a broad range of issues has been of considerable value to both management and the Board alike. Haydn Warman, our Company Secretary, will also retire in March after serving the Society for over 24 years. Since joining the Society in 1985, Haydn has assumed many responsibilities and was appointed Secretary in 1994 and a Director in 2002. Haydn's contribution to the Group both in legal and management matters has been invaluable. We wish them both well in their retirement.

On behalf of the Board, I would like to thank all Principality Group employees for the tremendous efforts they have made in a time of unprecedented change. Their contributions have ensured Principality retains its trusted reputation in the market and they are to be congratulated on all they have achieved in very difficult circumstances.

Community commitment

In 2009 Principality's commitment to its sponsorship, community initiatives and charity projects remained undiminished. Our ongoing support for a range of sporting, arts and cultural sponsorships with a pan Wales profile has remained central to our Corporate and Social Responsibility policies.

Sponsorship of the Welsh Rugby Union Principality Premiership continued and during 2009 we committed to a further term of sponsorship with the Football Association of Wales Welsh Principality Premier League.

In 2010, to coincide with our own 150th year anniversary celebrations, we will also be celebrating 30 consecutive years of our special sponsorship relationship with The National Eisteddfod, a pinnacle event in the arts and cultural calendar in Wales. As well as our major corporate sponsorships, we also invested in a range of community projects throughout the year. Our chosen Charity for 2009 was a joint charity collaboration with Tŷ Hafan and Tŷ Gobaith children's hospices based in South and North Wales respectively. Including money raised via our 2009 AGM, Principality Members and staff raised over £45,000 for the charities.

Member focus

Throughout 2009 we have continued our commitment to gathering the views and opinions of our Members by hosting a number of Member Talkback sessions across Wales. Events in Cardiff, Carmarthen, Deganwy and Swansea proved very successful and provided all attendees an opportunity to hear about and comment upon various aspects of our business plans and performance in direct dialogue with key Board members.

Delivering value to our Members has remained a key priority in 2009. This is evidenced by our savings and mortgage products receiving consistent coverage in the media throughout the course of the year, and by gaining independent recognition from Moneyfacts with the Society being recognised as one of the most consistent savings providers in their annual national survey. We also received a 5-star service award for the delivery of our mortgage products in the Financial Adviser Service Awards run by Financial Times Business.

2010 outlook

It remains to be seen whether the improvement in house price movements during the past six months will be sustained. In 2010 and beyond there will be serious constraints on public expenditure which in turn will suppress growth with a knock-on effect upon economic activity and employment. Whilst we do not underestimate the size of the challenge and the implications for the Society's business, the strength of our balance sheet, our strong and committed management team and staff and, above all, an extremely loyal membership will together ensure Principality's future as a vibrant independent Welsh financial institution.

Finally, I shall be retiring from the Board at the conclusion of the Annual General Meeting in April this year, having completed my term as Chairman. I should like to express my thanks to all those in Principality and in particular our Members, the Board and staff, who have given me so much help and support during my period of office.

Founded by the people of Wales in 1860, Principality is a vibrant Welsh business and one of the most trusted financial service sector brands on the high street. As we celebrate our 150th anniversary I have every expectation that my successor, who will be elected at the first Board meeting following the Annual General Meeting, supported by a strong Board and management, will lead Principality to even greater success in the years ahead.

It is the Board's responsibility to keep the Society's mutual status under review. Having considered the question once again, the Board concluded unanimously that the Society should continue to be run as a mutual for the benefit of current and future Members.

David B. Williams
Chairman
9 February 2010

Chief Executive's review

There is no doubt 2009 has been a year of profound change. However, it has been a year where the public mood has swung in favour of ethical businesses with long-term social gain as their core value. For those societies, like Principality, with strong capital and robust profitability, 2010, notwithstanding all the trading challenges, could prove to be the start of a renaissance.

Trust and fairness lie at the heart of our mutual proposition and our trusted brand continues to provide safety and security for our Members during one of the most turbulent periods on record.

2009 trading highlights

- Profit before tax of £14.3m, after charging a further contribution to the Financial Services Compensation Scheme of £1.4m.
- Strong capital ratios with a Tier 1 ratio of 12.49% (2008: 11.69%).
- An increase in retail savings balances of 6.63% to £4,933.2m.
- 104.1% (2008: 94.7%) of loans funded by customer deposits.
- Cost income ratio improvement from 58.04% to 52.08%.

In my review last year I predicted that 2009 trading conditions would be testing, the uncharted path to recovery would be difficult to tread and the mutual sector would face unprecedented consolidation pressures. Those predictions have all rung true and the pressures are unlikely to ease in the year ahead. Despite very difficult trading conditions, Principality has delivered a solid performance with all businesses performing ahead of expectation. Our balance sheet is in good shape and we remain well placed to deal with uncertainties ahead.

Our performance has been robust and we have delivered strong Member benefits through market-leading savings products. The core Society business had a strong year. Net savings inflows of £306.8m were generated and at year end 104.1% of our loans were funded by customer deposits. I am delighted to welcome over 67,000 new savers to Principality.

We have seen record levels of investment product and insurance sales as Members seek trusted advice from a trusted brand. Low mortgage volumes have impacted on growth but we are well placed to grow once conditions improve. Arrears are at lower than anticipated levels on our retail mortgage book and we have just 48 properties in possession.

Costs have been well managed as we seek to "do more for less" and major regulatory and IT projects have been delivered, improving service levels and operational resilience.

New developments

We understand the importance of offering our Members face-to-face advice and a friendly environment to discuss their financial needs. November 2009 saw the launch of our 51st branch in the St David's development, Cardiff. In addition we installed a further 5 ATMs across our branch network and we will continue to modernise and adapt our branches in 2010, demonstrating our ongoing commitment to the Welsh high street.

Group overview

Early and decisive actions taken in 2008 to slow down growth and contain costs have proved successful.

The Nemo secured lending portfolio also returned to profit having been hard hit in the early part of the year by the continued fall in house prices and rising default levels. Both trends showed solid improvements in the latter part of the year with house price falls stabilising and the increase in arrears abating. As predicted last year, margins have improved and we have provisions in place to cover losses. We would expect to continue to see higher levels of risk and return in this business in 2010 compared to the core business.

Our Commercial business turned in a very strong performance with record profits. Arrears and defaults remain at relatively low levels and compare very well against sector benchmarks. This is a quality Commercial book grown sensibly over many years. We did not write high risk loans nor did we acquire any loan books in the search for high yield, and we are now seeing the benefit of that approach coming through.

Peter Alan, our estate agency business, has returned to profit. Sales volumes were well ahead of plan as the market defied the critics and showed more resilience than expected. Moves into Lettings and Asset Management have strengthened our franchise. We have instigated pan-Wales property auctions with good success rates. The surveyors' business performed well, albeit volumes remain low in a depressed mortgage market. A lack of credit availability will continue to constrain the market in the short term.

Group pre-tax operating profit of £14.3m, representing an increase of £5.0m from 2008 (£9.3m), was arrived at after charging a further £1.4m Financial Services Compensation Scheme levy. The team can be proud of what we have achieved. The balance between risk and reward is a fine one and our objective of keeping all stakeholders content is one on which we believe we have delivered.

2009 market review

During the year we saw the failure of the Dunfermline Building Society, the creation of a new 'Super-Mutual' following the merger of the Britannia with the Co-op and recently we have seen the announcement of the planned merger of the Chelsea and Yorkshire Building Societies.

In addition we saw the introduction of new capital structures into the sector as the West Bromwich Building Society introduced 'Profit Participating Deferred Shares' to improve capital ratios. The Yorkshire proposed an issue of 'Contingent Convertible' debt instruments as part of their proposed merger arrangements and the drive for higher levels of Tier 1 capital will continue across the sector.

Our own capital ratios are strong but in common with all other societies, we will continue to consider all available options should we believe this to be in the interests of our Members.

Sector profitability continues to be challenged, Rating Agency downgrades swept across the sector and wholesale market funding remains constrained. The acquisition cost of retail savings is high and further erosion of net interest margins across the sector appears likely. The benefit of our diversified model is demonstrable and the Group has, against the trend, increased our net interest margin during the year.

The fully nationalised and majority-owned Government Banks along with National Savings benefit from state backing and are in a stronger position to attract retail savings. This is distorting the market and diluting the amount of savings available to mutuals.

Staff at our St. David's, Cardiff branch in 2009

Against this background we adopted a 'standstill' balance sheet strategy during the year which has proved to be sensible. It is likely that growth in 2010 will be similarly constrained until we are confident of more certainty in our funding lines. This does little to support the mortgage market, in particular first-time buyers, but we continue to face demands to build up capital and liquidity levels and need to manage the business with caution as our watchword.

Challenges ahead

We remain in the midst of a challenge between macro economic intervention on the one hand and the fractured banking system on the other. Recovery has been slow and will continue to be so. An election in 2010 could add a further new dimension. Regulatory demands for improved levels of high grade capital will continue unabated. The cost of savings will remain high and further sector consolidation appears inevitable. Our watchword is caution on every front.

Your Society has performed well and delivered on its promises. With your interests at heart we will endeavour to continue to do so in future. These remain the most testing of times. I believe that the recovery, slow as it is, has arrived. My expectation is that the year ahead will be one of uncertainty with many new challenges emerging. We remain well placed to meet these.

Over the last 150 years your Society has experienced several economic downturns and has weathered them all and continues to prosper. I am grateful for the support of my team, our Board and our Members. With pride in our past and confidence in our future we can all look forward with cautious optimism, but optimism none the less.

I would like to make special mention of David Williams, our Chairman, who will be retiring at the forthcoming Annual General Meeting. We are extremely grateful for the outstanding leadership and commitment David has provided to Principality in his 9 years with the business, first as a non-executive director and over the past 4 years in his role as Chairman. On behalf of the Board and all the Group's employees I would like to thank David for the pivotal role he has played in the Society's success story during his reign. His vision and passionate commitment to the Society's performance, people and Members ensure that he will always be revered and respected.

Peter L. Griffiths
Chief Executive
9 February 2010

Business review
for the year ended 31 December 2009

Income statement overview

The Group's profit before tax for the year to 31 December 2009 was £14.3m after charging a Financial Services Compensation Scheme levy of £1.4m and fair value adjustments of £6.5m. Excluding these items, underlying profit before tax for the Group was £22.2m (2008: £11.3m), up 96.5% on last year. This demonstrates a solid performance under very difficult market conditions and rising impairment charges, particularly in the secured personal lending portfolio. The results have been enhanced by gains from the prudent management of liquid assets.

Profit

Net interest margin

Net interest income is the sum of the amount earned on assets (a combination of retail mortgages, commercial mortgages and liquid assets) less liabilities (savings products and borrowings) divided by total average assets. At 1.69% (2008: 1.38%) the Group's net interest margin continues to benefit from the higher margins earned in the commercial lending and secured personal lending businesses and benchmarks very well against our peer group. Although market rates have been impacted by a lack of liquidity, the resulting interest rate environment has been beneficial to the Society as a net receiver of LIBOR, with margin earlier in the year benefiting from the higher than average differential between LIBOR and Bank Base Rate.

Net interest margin has been enhanced by gains of £3.8m (2008: £nil), equivalent to 4bps arising from the profit on the sale of gilts. However, the impact of this has been limited as interest rates paid on Member shares continue to re-price faster than mortgage and loan rates. It is anticipated that net interest margin will come under more pressure in the coming year due to the impact of the intense competition for retail funds and continuing disruption in the wholesale funding markets.

Other income

The Group's non-interest income includes insurance income, estate agency income and income generated from a number of other complementary activities. These together generated 13.36% (2008: 20.18%) of total income. Increases in the sale of life, investment and general insurance products have been offset by lower commission and profit share from payment protection insurance policies as a result of both lower sales and an increase in unemployment claims. Estate agency and lettings income, whilst broadly in line with last year, has started to show signs of recovery throughout the second half of the year which is expected to continue through 2010.

Administrative expenses

At 0.95% (2008: 1.04%), the improvement in the ratio of operating expenses as a percentage of total mean assets reflects the Group's focus on maintaining a tighter cost base, whilst at the same time ensuring the quality of products and services offered is maintained. These cost savings have been achieved without a redundancy programme in the Group during 2009.

Impairment provisions for losses on loans and advances

The charge for impairment provisions of £39.5m for the Group was £7.7m more than last year. The underlying quality and average loan-to-value ratio of 68.4% (2008: 57.5%) remains strong in both first charge residential and commercial lending. Provisions as a proportion of relative assets in these portfolios remained the same throughout the year. Accumulated impairment on our mortgages secured on commercial property at 0.86% of balances compares favourably with industry experience and reflects the lower risk nature of the lending undertaken in this area. Falling property values and further default through rising unemployment have resulted in the Group's secured personal lending portfolio making an additional charge for impaired loans of £32.4m (2008: £28.2m). Notwithstanding the high level of provisions, the secured personal lending portfolio has made a positive contribution to Group profit in the year.

Derivatives and hedge accounting

All derivatives are recorded on the balance sheet at fair value with any valuation movements being taken to the income statement. Derivatives are only used to the extent to which the Group will be affected by changes in interest rates or other market indices and are therefore used solely to hedge risk exposures and not for speculative purposes.

The £6.5m relating to fair value adjustments on derivatives and hedge accounting represents the net fair value adjustments on derivative instruments that are matching risk exposures on an economic basis. Some income statement volatility arises on these items due to accounting ineffectiveness of designated hedges or because hedge accounting has not been adopted or is not achievable. The debit is primarily due to timing differences in cash flows and interest rate reset dates between the derivative instrument and the hedged assets and liabilities. The impact can be volatile, especially so in current market conditions, but will trend to zero over time.

Taxation

The effective tax rate for the Group is 24.47% (2008: 38.71%) compared with the standard rate of tax of 28.00% (2008: 28.50%).

Key Performance Indicators

The following indicators illustrate the Principality Group's performance during 2009 compared to the preceding four years:

Year ended 31 December	2009	2008	2007	2006	2005
Capital and Profit					
Tier 1 capital ratio	12.49%	11.69%	9.75%	11.21%	9.97%
Gross capital ratio	8.52%	8.00%	8.53%	9.99%	7.31%
Free capital ratio	8.71%	7.94%	8.07%	9.10%	6.35%
Solvency ratio (2008: Basel II)	17.13%	15.95%	13.33%	15.58%	12.60%
General reserve	£287.9m	£283.5m	£277.3m	£257.8m	£236.5m
Profit before tax	£14.3m	£9.3m	£30.6m	£29.0m	£22.6m
Profit after tax as a % of mean total assets	0.17%	0.09%	0.38%	0.44%	0.37%
Profit after tax as a % of mean total assets (excluding FSCS levy)	0.19%	0.15%	0.38%	0.44%	0.37%
Net interest income as % of mean total assets	1.69%	1.38%	1.28%	1.37%	1.26%
Other income as % of net operating income	13.36%	20.18%	34.45%	35.25%	30.85%
Operating expenses as % of mean total assets	0.95%	1.04%	1.27%	1.38%	1.23%
Assets					
Total assets	£6,218.9m	£6,398.7m	£5,852.5m	£4,830.2m	£4,384.3m
Growth	(2.81%)	9.33%	21.17%	10.17%	8.10%
Loans and advances to customers	£4,736.9m	£4,884.3m	£4,584.0m	£3,887.9m	£3,522.2m
Gross lending in the year	£683.5m	£1,125.9m	£1,602.3m	£1,313.8m	£965.6m
Liquid assets	£1,380.3m	£1,382.0m	£1,196.7m	£875.6m	£803.6m
Liquid assets as % of shares and borrowings	24.49%	23.98%	22.39%	20.12%	19.89%
Funding					
Shares	£4,933.2m	£4,626.4m	£3,804.3m	£3,406.1m	£3,225.0m
Borrowings	£713.6m	£1,186.0m	£1,540.0m	£946.3m	£815.0m
Funding limit	12.78%	20.60%	29.03%	22.05%	20.58%
Employees					
Average number of people employed	1,049	997	1,206	1,004	903
Other measures					
Number of branches	51	50	50	50	51
Number of estate agency branches	23	23	26	25	25

The rate differential is mainly due to prior year current and deferred tax adjustments in the secured personal lending portfolio amounting to a tax rate difference of 4.91% offset by expenses incurred not allowable for tax.

Balance sheet

Loans and advances to customers

The Group continues to focus on the quality of business written, concentrating on affordability and loan-to-value ratios in underwriting loans and mortgages. Lending criteria remains tight and lending volumes deliberately reduced, especially in the Group's secured personal lending business. The Board's primary concern remains the sustainability of the business so that it can deliver value to Members well into the future. With this in mind, management will continue to prudently apply controls to the Group's lending, reflecting the changing business environment. As a result, mortgage assets in 2009 fell by 3.02% to £4,736.9m.

Treasury and liquid assets

Liquid assets have remained flat over the course of the year and represent 24.49% of shares and borrowings (2008: 23.98%). Particular focus has been placed on the quality and liquidity of the assets held, with 36.84% of the portfolio being held in sovereign exposures (2008: 17.32%). Other than sovereign exposures, liquidity is held in the form of investments with other financial institutions with 96.78% (2008: 96.72%) of these exposures rated between A and AAA under Fitch credit ratings.

The transition towards holding a greater balance of sovereign exposures highlights the progress the Group is making towards meeting the asset buffer requirements outlined in the FSA's new liquidity guidelines for BIPRU firms 'Strengthening Liquidity Standards' and this will be a key focus during 2010.

Funding

The Society has a strong and diversified funding base, predominately represented by retail savings. As a result, less reliance is placed on wholesale markets. The savings environment is increasingly competitive as institutions who have previously relied on wholesale funds take a larger share of the retail market and savers choose to pay down their debts or seek higher returns from equity-linked investment products. Management's focus has been to grow savings balances and retain the record growth of savings balances achieved in 2008, compensating for the restriction on access to the wholesale markets as a result of industry-wide downgrades.

This growth and retention strategy has been underpinned by a strong take-up of fixed rate bonds which now represent 54.12% of all savings balances (2008: 32.51%). As a consequence, savings balances have increased by 6.63% to £4,933.2m (2008: £4,626.4m) representing over 104.1% (2008: 94.72%) of all mortgage balances.

Borrowings from wholesale ('money market') sources, administered by the Group's treasury function, have fallen significantly during the year by 39.83% to £713.6m. In November the Society repaid £192m of maturing medium-term funding. Notwithstanding this, the Society has been able to maintain strong liquidity levels throughout the year. At 12.78% (2008: 20.60%) of all shares, deposits and loans, the Group's borrowings represent a low dependence on financial markets. Principality's strong retail brand and reputation has allowed choice over funding sources during a period when wholesale markets remain subdued. Balancing the mix of funding through wholesale markets and retail remains a key focus and the Board is committed to maintaining a prudent position.

In order to diversify funding sources, the Group entered into a Covered Bond Programme on 22 January 2009. The Programme involved the formation of Principality Covered Bond LLP which provides security to a £700m AAA rated bond issued internally by the Society.

During the year, and in common with many other societies, the Society's debt ratings with Fitch and Moody's were downgraded but still retained investment grade status. At the end of the year the ratings were:

	Short-term	Long-term
Fitch	F2	BBB+
Moody's	P2	Baa2

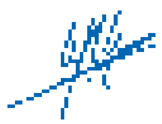
The reduced ratings have restricted access to the wholesale markets but we have mitigated the impact through our successful retail funding strategy.

Capital

Capital comprises the Group's general reserve, permanent interest bearing shares (subscribed capital) and subordinated debt. This capital is held to support the development of the business, to protect Members' deposits and provide a buffer against unexpected losses. The amount of capital required is assessed in relation to the Group's overall risk appetite, the material risks to which the Group is exposed and the management strategies employed to manage those risks. During 2009 total capital has increased from £479.8m to £480.4m.

Since 1 January 2008 and throughout the year, the Group has managed its capital in accordance with the EU Capital Requirements Directive (Basel II), as required by the FSA. This supercedes the requirements of the Capital Accord (Basel I). At 31 December 2009, regulatory capital stood at £462.9m (2008: £457.5m) with the Group's total solvency ratio, a measure of the Group's total capital as a proportion of the Group's risk weighted assets at the balance sheet date, increasing by 1.18% to 17.13% (2008: 15.95%). This is well in excess of the minimum established by the FSA. The Tier 1 ratio has also increased to 12.49% (2008: 11.69%) and compares very favourably, not just against our peer group, but against larger banks and other financial institutions.

During the year the Group has continued to perform internal stress tests regularly on its capital base, and these tests have consistently demonstrated a capital surplus after allowing for extreme stress scenarios.



W. Guy Thomas
Group Finance Director
9 February 2010

Risk management report

Risk governance

The management of the business and the execution of the Group's strategy are subject to a number of risks. The principal elements are credit risk, market risk, liquidity risk, operational risk and pension obligation risk. The Group aims to manage appropriately all the risks that arise from its activities. As such the Group believes that its risk management philosophy should be based on an awareness of actual and potential risk exposures, the quantification of the probable impact of such exposures and the development and implementation of measures that manage such exposures within agreed limits. As a mutual, the Group maintains a relatively low risk appetite, as evidenced by the quality of the balance sheet.

There is a formal structure for managing risks across the Group which includes detailed risk management policies which document the approach to the management of risk. These policies, including associated limits, are owned and reviewed at least annually by functional risk committees which report to the Group Risk Committee, Executive Committee and the Board.

Risk governance is provided by a structure consisting of six key risk management committees. Each committee includes appropriate representation from the Executive Committee, divisional managers and credit risk specialists:

- Group Risk Committee, chaired by a non-executive director, which has responsibility for ensuring a Group-wide co-ordinated approach across all risks.
- Building Society Management Board, which has responsibility for retail credit risk.
- Commercial Lending Asset Management Committee, which has responsibility for commercial credit risk.
- Nemo Board, which has responsibility for secured personal lending credit risk.
- Asset and Liability Committee, which has responsibility for market and liquidity risk.
- Commercial Lending Credit Committee, which has responsibility for sanctioning commercial loan applications which fall within the criteria defined by the Board.

Primary responsibility for the identification, control and mitigation of risk rests with each business unit. Oversight and governance are provided through specialist support functions including Group Risk, Treasury and Group Finance. The role of these functional specialists is to maintain and review policies, establish limits which are consistent with the Group's risk appetite, monitor and report on compliance of those limits and generally to provide an oversight role in relation to the management of risk.

Group Internal Audit provides independent assurance regarding the activities of the business units and the specialist units across the business. The Audit Committee monitors the arrangements for assessing risk inherent in the Group's business activities on behalf of the Board and receives quarterly risk reports. The Board receive risk reports at each of their meetings and the Board has continued its programme of quarterly reviews of major strategic risks.

Credit risk

Credit risk is the potential risk that a customer or counterparty will fail to meet their financial obligations to the Group as they become due. Credit risk arises primarily from loans to retail customers, loans to commercial customers and from the liquid and investment assets held by Group Treasury for liquidity requirements and for general business purposes.

The controlled management of credit risk is critical to the success of the Group's lending and liquidity portfolios. The quality of individual lending decisions, the subsequent management and control, together with the application of a credit policy that reflects the risk appetite of the business, has a direct impact on the achievement of the financial objectives of the Group.

Each business area, residential first and second charge lending, commercial lending and treasury, has its own individual Credit Risk Policy Statement setting out its risk appetite and including policy scope, structures and responsibilities, definitions of risk and risk measurement and monitoring. In addition, each business area has its own detailed Procedures Manual setting out operating rules and standards.

Day-to-day management of credit risk is undertaken by specialist teams working in each business area in compliance with policies approved by the Board. Such functions undertaken include credit sanctioning, portfolio management and management of higher risk and defaulted accounts.

The Group continues to focus on the quality of the business written. Lending criteria remain tight and lending volume deliberately reduced, especially in the Group's second charge loan business and commercial lending. The Group's collections and recoveries functions aim to provide a responsive and effective operation for the arrears management process. The Group encourages early two-way communication with borrowers, obtaining their commitment to maintain payment obligations, typically through repayment plans. Experience in these areas allows for feedback into the underwriting process.

In common with other building societies, the Group participates in the Government's Mortgage Rescue Scheme but has chosen not to take part in the Homeowner Mortgage Support Scheme.

The Group's forecasts and plans have taken account of the risk of further decreases in house prices, deterioration in the economic environment, and increases in unemployment. These forecasts have been prepared and stressed accordingly in line with FSA guidance. The extent of further economic slowdown, its impact upon arrears performance and falls in house prices affect the level of impairment losses.

Treasury counterparty lines of credit are reviewed on a monthly basis. This entails an analysis of the counterparties' financial performance, their ratings status and recent developments to ensure that limits remain within the Group's risk appetite. Changes to lines and limits are approved by the Asset and Liability Committee. Treasury counterparty exposures are reviewed on a weekly basis by the Executive Committee.

Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes as a result of changes in market prices, the principal elements being interest rate risk and foreign currency risk.

Group Treasury is responsible for managing the Group's exposure to all aspects of market risk within the operational limits set out in the Group's treasury policies. Oversight is provided by the Asset and Liability Committee (ALCO). ALCO approves the market risk policy and receives regular reports on all aspects of market risk, including interest rate risk and foreign currency risk. Reporting lines and terms of reference are set out clearly by the Board which also receives monthly reports from the Group Finance Director covering significant issues dealt with by ALCO.

The Group's defined benefit pension scheme is also subject to market risk and this risk is managed by the trustees of the scheme.

Interest rate risk

Interest rate risk is the risk of loss resulting from adverse movements in market interest rates.

The Group is exposed to interest rate risk, principally arising from the fixed rate mortgage and savings products that it offers. The various interest rate features and maturities on these products, and the use of wholesale funds to support these products, create interest rate risk exposures due to the imperfect matching of interest rates between different financial instruments and the timing differences on the re-pricing of assets and liabilities.

Another significant form of interest rate risk arises from the imperfect correlation between re-pricing of interest rates on different assets and liabilities, often referred to as basis risk. The basis risk on the Group's balance sheet arises from administered liabilities which are priced relative to base rate, but are invested in money market assets earning a LIBOR return.

Interest rate risk is managed on a continual basis, within limits set by the Board, using appropriate financial instruments including derivatives.

The Building Society Management Board regularly considers, in particular, the Society's options and strategies in the current low interest rate environment and the impact of any future increases in interest rates. The Group's forecasts and plans have taken account of the risk of interest rate changes and have been prepared and stressed accordingly in line with recent FSA guidance.

Use of derivatives

Derivatives are only used to limit the extent to which the Group will be affected by changes in interest rates, foreign exchange rates or other indices which affect fair values or cash flows. Derivatives are therefore used exclusively to hedge risk exposures.

The principal derivatives used by the Group are interest rate exchange contracts, commonly known as interest rate swaps, interest rate options and interest rate caps.

The table below describes the principal activities undertaken by the Group, the related risks associated with those activities and the types of derivatives which are typically used to manage such risks.

Currency risk

Currency risk is the risk of a loss resulting from movements in foreign exchange rates or changes in foreign currency interest rates, particularly on the Group's non-Sterling funding. The majority of currency balances arise from transactions instigated by Group Treasury to manage wholesale funding costs and returns on liquid assets and to provide diversity in funding and asset markets.

Currency risk is not significant for the Group as almost all transactions are in Sterling.

Interest Rate Risk Management

Activity	Risk	Type of derivative
Fixed rate savings products and fixed rate funding	Sensitivity to changes in interest rates	Interest rate swaps and options
Fixed rate mortgage lending and fixed rate investments	Sensitivity to changes in interest rates	Interest rate swaps and options
Capped rate mortgages	Sensitivity to changes in interest rates	Interest rate caps
Equity linked investment products	Sensitivity to equity indices	Interest rate swaps and equity linked options

The Group uses derivatives in accordance with the Building Societies Act 1986. This means that such instruments are not used in trading activity or for speculative purposes and, accordingly, they are used exclusively to reduce the risk of loss arising from changes in interest rates, foreign exchange rates or other factors specified in the legislation.

Liquidity risk

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due, or can do so only at excessive cost. The objective of the Group's liquidity policy is therefore to maintain sufficient liquid assets to cover cash flow imbalances and fluctuations in funding, to maintain full public confidence in the Group and to ensure that all financial obligations are met.

The day-to-day management of liquidity is the responsibility of Group Treasury, which manages the Group's portfolio of liquid assets and wholesale funding facilities.

ALCO exercises control over the Group's liquidity through the operation of strict liquidity policies and close monitoring, receiving regular reports on current and projected liquidity positions including the impact of stress testing thereon. The policy is to maintain sufficient liquid resources to cover day-to-day fluctuations in funding as well as more severe, and less likely, demands. Attention has been focused towards the more severe liquidity definitions and stress scenarios and, as a consequence, the Group has maintained the size of its liquid assets which has helped to provide a buffer against the turmoil in the financial markets during the year.

On 22 January 2009, the Group entered into a Covered Bond Programme to diversify its funding sources and further reduce any liquidity risk. Cash proceeds have been obtained through repurchase transactions ('repos') rather than from the outright sale of associated Treasury Bills connected to the Covered Bond Programme.

The Group also complies with regulatory guidelines which govern the scope and nature of the Group's holding and reporting of liquid assets. In the current climate, liquid asset maturities are matched with the maturity profile of the Group's liabilities to ensure that financial obligations are covered as they fall due. The Group continues to monitor its cash flows on a daily basis and has developed further its stress tests to ensure that contingency plans are sufficient to meet any unexpected events.

87.4% of the Group's funding comes from retail sources. The Society has been particularly successful in obtaining and retaining retail savings over the last year as savers look for a safe haven for their savings. The Society faces increasing levels of competition for retail savings and will continue to enhance its product range to maintain its competitive position.

Management applies prudent policies to ensure the interests of Members and depositors are protected and that public confidence in the Group is maintained.

Operational risk

Operational risk is the risk of a loss arising from inadequate or failed internal processes or systems, human error or external events. For the purposes of managing operational risk, the Group divides it into a number of discrete areas of risk which include, for example, process management, systems failure and fraud risk.

The Group's operational risk management framework sets out the strategy for identifying, assessing and managing operational risk, with senior management having responsibility for understanding how it impacts on their business areas and for putting in place the appropriate controls such as business continuity management, disaster recovery and insurance. The framework is regularly reviewed and updated to ensure it remains appropriate to identify, monitor and manage exposure to existing and emerging operational risks faced by the Group.

Pension obligation risk

The Group has funding obligations for a defined benefit scheme which is closed to new entrants. Pension risk is the risk that the value of the Fund's assets, together with ongoing employer and member contributions, will be insufficient to cover the projected obligations of the Fund over time. The return on assets, which includes equities and bonds, will vary with movements in equity prices and interest rates. The projection of the Fund's obligations includes estimates of mortality, inflation and future salary rises, the actual out-turn of which may differ from the estimates. The Fund is also exposed to possible changes in pension legislation.

To mitigate these risks, management , together with the Trustees of the Fund, regularly review reports prepared by the Fund's independent actuaries to assess these risks and take appropriate actions which may, for example, include adjusting the investment strategy and/or contribution levels.

Capital management

The Group conducts an Internal Capital Adequacy Assessment Process (ICAAP) at least annually. This is used to assess the Group's capital adequacy and determine the levels of capital required to support the current and future risks in the business. The outcome of the ICAAP is presented in a document covering all material risks to determine the capital requirement over a five-year horizon and includes stress scenarios which are intended to meet regulatory requirements. The capital requirements are presented to the Board for approval with the most recent review being completed in November 2009. The ICAAP is used by the FSA to determine and set the Group's Individual Capital Guidance (ICG).

The amounts and composition of the Group's capital requirement is determined by assessing the Basel II Pillar 1 minimum capital requirement, the Group's economic capital requirement, the impact of stress and scenario tests under Pillar 2 and the ICG. The Group manages its capital above the ICG at all times. Capital levels for the Group are reported to, and monitored by the Board on a monthly basis.

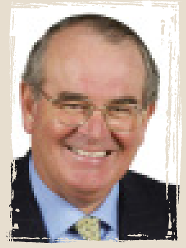
Risk management

Under Basel II Pillar 3, the Group is required to publish further information about its exposures and its risk management procedures and policies. It is anticipated that the 2009 version of the Pillar 3 report will be published on the Society's website (www.principality.co.uk) in April 2010.

The Group has applied to the FSA for permission to use an Internal Ratings Based ('IRB') approach to retail credit risk and capital management. This will allow the Group to use its own estimates of risk, rather than values prescribed by the FSA, after certain conditions have been satisfied, and will further enhance the Group's risk management processes.

W. Guy Thomas
Group Finance Director
9 February 2010

Board of directors at 31 December 2009



David B. Williams (age 69)
Chairman

Became non-executive Chairman in 2006 having been appointed a non-executive director on 1 November 2000. He is Chairman of the Nominations Committee and a member of the Remuneration and Commercial Lending Credit Committees.

Eurfyl ap Gwilym BSc PhD (age 65)
Deputy Chairman

Appointed a non-executive director on 9 June 2000. He is a director of Nemo Personal Finance Limited and Loan Link Limited, a member of the Nominations Committee and Chairman of the Trustees of the Principality Building Society Pension and Assurance Scheme.

Other Directorships and Appointments:
Director and Trustee of the Institute of Welsh Affairs, and a Director of Wafer plc.

Peter L. Griffiths ACIB (age 51)
Chief Executive

Joined Principality in December 2001 and became Chief Executive in March 2002. He was appointed a director on 2 January 2002. He is Chairman of: Peter Alan Limited, Nemo Personal Finance Limited, Loan Link Limited and Friary Two Limited. He is a director of all the Society's subsidiary undertakings which have not carried on business throughout the year. These can be seen listed in Note 22 on page 51. He is Chairman of the Executive Committee and Commercial Lending Asset Management Committee, Commercial Lending Credit Committee and Building Society Management Board. He is a member of the Asset and Liability and Group Risk Committees.

W. Guy Thomas
BSc (Hons) ACA FCT C.Dir (age 54)
Group Finance Director

Joined the Society as Finance Director on 1 November 2003. He is Chairman of Friary One Limited and a director of Peter Alan Limited, Nemo Personal Finance Limited, Loan Link Limited, Principality Covered Bond LLP and Friary Two Limited. He is also Chairman of the Asset and Liability Committee and a member of the Executive Committee, Commercial Lending Asset Management, Group Risk and Commercial Lending Credit Committees.

Haydn Warman LLB (age 59)
Director and Secretary

Joined Principality as Assistant General Manager in 1985, appointed Secretary in 1994. He was appointed a director on 1 October 2002. He is a director of Nemo Personal Finance Limited and Loan Link Limited. He is also a member of the Executive Committee, Asset and Liability and Group Risk Committees.

Other Directorships and Appointments:
Governor of the University of Glamorgan and a member of the Audit and Risk Management Committee of the Wales Audit Office.

Christopher A. Jones BA (age 46)
Non-Executive Director

Appointed a non-executive director on 1 April 2006. He is a company director. He is Chairman of the Remuneration Committee and a member of the Nominations Committee.

Other Directorships and Appointments:
Director of Dwr Cymru Cyf, Glas Cymru Cyf, Glas Cymru (Securities) Cyf, Dwr Cymru (Financing) Limited, Welsh Water Utilities Finance PLC and Dwr Cymru (Holdings) Limited. He is also Deputy Chairman of the Council of The Prince's Trust Cymru.

Gordon MacLean BA FCA (age 55)
Non-Executive Director

Appointed a non-executive director on 1 April 2006. He is a company director. He is Chairman of the Audit Committee and a member of the Nominations Committee.

Other Directorships and Appointments:
9 Highcliffe Road Management Limited.

Langley Davies
BSc (Hons) ACA (age 50)
Non-Executive Director

Appointed a non-executive director on 1 May 2007. He is a director of Nemo Personal Finance Limited and Loan Link Limited and a member of the Audit and Commercial Lending Credit and Nominations Committees.

Other Directorships and Appointments:
Partner in Ruperra Properties LLP and Hensol Properties LLP. Director of Vansdirect.co.uk Limited, Raglan Consultancy Limited and Fast First Limited.

Keith Brooks (age 61)
Non-Executive Director

Appointed a non-executive director on 1 May 2007. He is a director of Peter Alan Limited and a member of the Group Risk, Commercial Lending Credit, Remuneration and Nominations Committees.

Other Directorships and Appointments:
Chairman of Vista Retail Support Group Limited and Vansdirect.co.uk Limited. Director of Fast First Limited and a partner in Airport Investments and Enterprises.

Graeme Yorston
FCIB MBA (age 52)
Chief Operating Officer

Joined the Society as Chief Operating Officer on 3 July 2006 and was appointed a director on 19 October 2007. He is a member of the Executive Committee, Building Society Management Board, Asset and Liability Committee and Group Risk Committee.

Joanne Kenrick LLB (age 43)
Non-Executive Director

Appointed a non-executive director on 1 January 2009. She is a member of the Audit and Nominations Committees.

Other Directorships and Appointments:
Trustee on the Board of the Employers Forum on Disability and a Director of the 53 Rosslyn Hill Residents Society Limited.

Christopher Rowlands (age 53)
Non-Executive Director

Appointed a non-executive director on 1 June 2009 having previously served on the Board from December 2004 to January 2007. He is Chairman of the Group Risk Committee and a member of the Commercial Lending Credit and Nominations Committees.

Other Directorships and Appointments:
Director of Gardens Pensions Trustees Limited

Dyfrig John FCIB (age 59)
Non-Executive Director

Appointed a non-executive director on1 July 2009. He is a member of the Commercial Lending Credit, Nominations and Remuneration Committees.

Other Directorships and Appointments:
Board member - Wales Millennium Centre, member of the Advisory Board for Bangor Business School and President of the HSBC Bank UK Pension Association.

Directors' report

for the year ended 31 December 2009

The directors are pleased to present the Annual Report and Accounts and Annual Business Statement of the Society and its subsidiary undertakings for the financial year ended 31 December 2009.

Directors

The names of the directors at the date of this report, together with brief biographical details, are listed on pages 12 and 13.

The following appointments were made to the Board during 2009; Jo Kenrick (1 January), Christopher Rowlands (1 June) and Dyfrig John (1 July). At the Annual General Meeting to be held on 23 April 2010 they will each stand for election under Society Rule 25(4) and Guy Thomas and Langley Davies will retire by rotation under Rule 26(1). All five are eligible and willing to continue serving on the Board and there have been no other nominations.

During the year no director of the Society was, or has since been, beneficially interested in shares in, or any debentures of, any connected undertaking of the Society.

Business objectives and activities of the Society and its subsidiaries

The Society's business objective is to provide Members with the benefits of a mutual organisation through the design, manufacture and delivery of attractive mortgage and savings products. The Society's principal activity is the provision of housing finance funded mainly from Members' savings. It also offers commercial loans and a range of insurance and financial services.

The Society's trading subsidiaries engage in complementary activities including:

- estate agency and property services; and
- the provision of secured personal loans.

The directors consider that no activities carried out during 2009 were outside the powers of the Society.

The Society has not acquired or established, or allowed a subsidiary undertaking to acquire or establish, a 'non-core' business to which Section 92A of the Building Societies Act 1986 applies.

New activities

- Whilst there has been consolidation in the sector since the credit crunch first struck, the Society remains committed to the High Street having recently opened its 51st branch in Cardiff's new St David's development and;
- A new Customer Relationship Management (CRM) IT system was launched in the year allowing customer-facing staff to see all customer holdings through a single system thereby gaining a better insight into customer needs.

Profits and capital

Profit before tax was £14.3m (2008: £9.3m). The profit after tax transferred to the general reserve was £10.8m (2008: £5.7m).

Total Group general reserves at 31 December 2009 were £287.9m (2008: £283.5m). Gross capital at 31 December 2009 was £480.4m (2008: £479.8m), including £125.6m of subordinated debt and £65.1m of permanent interest bearing shares (PIBS).

The ratio of gross capital as a percentage of shares and borrowings at 31 December 2009 was 8.52% (2008: 8.00%) and the free capital ratio was 8.71% (2008: 7.94%). The Annual Business Statement on page 71 contains an explanation of these ratios.

Important events since the year-end

On 15 January 2010 the Society repurchased £10.0m of subordinated debt at a discount. As a result, whilst remaining adequately capitalised, the Group has benefited from a one-off gain of £3.1m which will be accounted for in 2010.

Mortgage arrears

At 31 December 2009 there were 438 accounts across the Group on which payments were 12 or more months in arrears (2008: 298). Within these accounts the total amount of principal outstanding was £19.0m (2008: £12.0m) and the total amount of arrears was £3.2m (2008: £2.1m), for which provision has been made where appropriate.

Material differences between market and book value of land/buildings

The Board considers that the overall market value of the Group's freehold and leasehold properties is in excess of the book value.

Corporate social responsibility

Charitable donations

During the year the Group made charitable donations of £45k (2008: £45k). No contributions were made for political purposes.

Supplier payment policy

It is the Society's policy to discharge suppliers' invoices for the complete provision of goods and services (unless there is an express provision for stage payments) in full conformity with the conditions of the purchase and within the agreed payment terms. It is intended that this policy be continued in 2010.

At 31 December 2009 the total amount owed to suppliers was equivalent to 22 days' credit (2008: 20 days).

Environmental policy

The Society has continued its investment in environmental projects and remains committed to working with environmentally conscious partners.

In 2008 a review was undertaken of heavy plant equipment which was old and not particularly efficient. As a result new plant equipment was installed in 2008 to reduce the consumption of gas and electricity as well as reducing the CO_2 emissions generated. The new plant equipment was commissioned in early 2009 and has provided the ability to manage the heating and air conditioning across our Headquarters from a central PC allowing the environment to be individually controlled on each floor. A similar pilot is being undertaken in a number of branches to see if the same improvements can be made.

We continue to review and investigate new initiatives with the aim of further reducing the environmental impact of business operations.

Employees

The Society recognises the importance of effective communication with staff. Communication includes an intranet site, in-house publications, conferences and regular team cascade meetings. Employee feedback is welcomed and encouraged through a variety of methods such as a joint staff and management forum and participation in staff surveys. In addition, there is regular consultation with union representatives.

Great importance is placed on the recruitment, training and retention of high-calibre employees. Competitive remuneration packages and individual performance plans, clearly linked to corporate objectives through balanced business scorecards, are key elements in the reward strategy.

It is the Society's policy to ensure that all employees and applicants for employment are afforded equal opportunity regardless of gender, sexual orientation, ethnic origin, age or disability. Wherever practicable,

Graeme Yorston & Frank Ady from Tŷ Hafan arrangements will be made for continuing the employment of, and arranging appropriate training for, employees who become disabled during their employment with the Society.

Auditors

At the Annual General Meeting on 24 April 2009 the Members passed a resolution that Deloitte LLP be appointed as auditors for the ensuing year.

Responsibilities of the directors

The following statement, which should be read in conjunction with the statement of the auditors' responsibilities on page 26, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, the Report of the Remuneration Committee, the Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 to prepare, for each financial year, Annual Accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of affairs of the Society and the Group as at the end of the financial year and which provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it. In preparing the Annual Accounts, the directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Annual Accounts; and
- prepare the Annual Accounts on the going concern basis, unless it is inappropriate to presume that the Society will continue in business.

In addition to the Annual Accounts, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Society and its connected undertakings.

Directors' responsibilities for accounting records and internal controls

The directors are responsible for ensuring that the Group:

- keeps accounting records in accordance with the Building Societies Act 1986; and
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Financial Services Authority under the Financial Services and Markets Act 2000.

The directors have general responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are also responsible for the integrity of the Society's website www.principality.co.uk. The work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website. Information published on the internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements. Information in these financial statements is provided under the legislation of the United Kingdom.

Going concern

The Chairman's statement and Chief Executive's review on pages 2 to 5, together with the Business Review on pages 6 to 8, set out a review of the business for the year and the Society's future plans. In addition note 40 to the financial statements on pages 61 to 69 gives detail of the Group's financial instruments and hedging activities; and its exposures to credit, liquidity and market risk. The principal risks and uncertainties faced by the Society and the Group, financial risk management objectives and policies, and the way in which the Group uses financial derivatives, are summarised in the Risk Management Report on pages 9 to 11 and in note 40 on pages 61 to 69.

As presented in the Consolidated Balance Sheet, the Group meets its funding requirements mainly from retail sources supplemented from wholesale sources. The current economic conditions create some uncertainty over the availability of wholesale funding in the foreseeable future. The Group's forecasts and projections include scenario testing as carried out in accordance with the Internal Capital Adequacy Assessment Process (ICAAP), which is a process required by the FSA to demonstrate appropriate levels of capital under stressed conditions. This takes account of possible extreme changes in trading performance, and shows that the Group will be able to operate within the sources of funding currently available to it. In addition to these sources, additional contingency funding plans are in place.

The Group monitors its liquidity levels so as to ensure that an appropriate level of resources is maintained to meet the requirements of the business. These are assessed under a number of stressed scenarios reflecting the directors' views of different risks that might arise under the current economic conditions. The assets held for liquidity purposes are assessed and reviewed for counterparty risks, and the directors consider that the Group is not exposed to losses on those assets that would affect the decision to adopt the basis of going concern. The directors consider that the overall level of capital, including Tier 1 capital of £345.7m (12.49% as a percent of risk-weighted assets) and a solvency ratio of 17.13% is adequate. Having considered the plans and forecasts for the Group, the directors believe that there are no material uncertainties that lead to significant doubt on the Group's ability to continue in business for our Members as a mutual building society for the foreseeable future. Accordingly, the financial statements continue to be prepared on a going concern basis.

The future

It is the Board's responsibility to keep the Society's mutual status under review. In our annual strategic review we concluded quite clearly that the Society should continue to be run for the benefit of current and future Members rather than in the interests of external shareholders.

2010 will undoubtedly bring further challenges. There will be enhanced supervisory guidance for building societies in relation to treasury and credit risk management, and the Society is well prepared to fulfil the FSA's requirements. Serious constraints on public expenditure will be expected to restrict growth with a knock-on effect upon economic activity and employment with significant implications for the Society's business. Nevertheless the Board is confident that Principality is well equipped to meet these challenges and will continue to prosper as a vibrant, independent, Welsh financial institution.

On behalf of the Board of Directors

David B. Williams
Chairman
9 February 2010

New touch screen technology in our Peter Alan branches.

Corporate governance report

The Society has continued to comply with the Combined Code on Corporate Governance in so far as its provisions are relevant to building societies.

The Board

The Board focuses on strategic issues, control of the business, review of operational and management performance, oversight of subsidiary companies and maintaining a system of effective corporate governance. The Board Controls and Procedures Manual sets out matters reserved to the Board and those which are delegated to management. This is reviewed annually by the Board.

The Board operates through its regular monthly meetings and five committees – Audit, Remuneration, Nominations, Group Risk and Commercial Lending Credit.

Board committees

Audit Committee

The Committee is chaired by Gordon MacLean with Langley Davies and Jo Kenrick as its other members, all of whom are independent non-executive directors. Keith Brooks, a non-executive director, was a member of the Committee during part of the year. Gordon MacLean and Langley Davies have recent and relevant financial experience. The Chief Executive, the Group Finance Director, the Society Secretary, the Head of Group Audit, the Head of Group Compliance, the Director of Group Risk and representatives of Deloitte, the external auditors, attend each meeting. The Assistant Secretary acts as secretary to the Committee. The Committee acts as an Audit Committee for the Society and its subsidiary companies.

During the year the Committee met on six occasions. It monitored the integrity of the financial statements and formal announcements relating to the Group's financial performance and reviewed relevant accounting policies and any significant financial judgements contained in them. The Committee has reviewed the effectiveness of the Group's financial controls and the internal control and risk management systems, compliance with financial services legislation and regulations, and has monitored progress to ensure that any required remedial action has been or is being taken on any identified weaknesses.

The Committee reviewed Deloitte's overall work plan and approved their remuneration and terms of engagement and considered in detail the results of the audit, Deloitte's performance and independence and the effectiveness of the overall audit process. The Committee recommended Deloitte's re-appointment as auditors to the Board and this resolution will be put to Members at the 2010 Annual General Meeting.

The Committee has implemented the Group's policy which restricts the engagement of Deloitte in relation to non-audit services. The policy is designed to ensure that the provision of such services does not have an impact on the external auditors' independence and objectivity. It identifies engagements that can only be undertaken with appropriate authority from the Committee Chairman or the Committee where non-audit fees will exceed pre-set thresholds. The Committee receives an annual report on the non-audit services being provided and the cumulative total of non-audit fees. The non-audit work undertaken during 2009 related to tax advice but work was also carried out on risk management consultancy. The non-audit fees for the year, including tax advice, were £229k and the audit fee for the year in respect of the Group was £124k.

The Committee has approved the Group Internal Audit plan and regularly reviewed the Internal Audit department's resources, work progress, results and management's implementation of its recommendations. During the year the Committee agreed the appointment of Steven Fuse as the Head of Group Internal Audit. He has direct access to the Committee Chairman and the Society Chairman. The Committee has held private meetings with him, the Head of Group Compliance and Deloitte during the year.

The Committee has reviewed the 'whistleblowing' procedures in place across the Group during the year and confirmed that arrangements are in place to enable individual employees to raise concerns about possible improprieties on a confidential basis. The Group has a financial crime policy and the Audit Committee receives an update at each meeting in relation to any material fraud and associated action taken.

The Committee reports on its activities to the Board.

Auditor independence

The appointment of external auditors is coordinated through the Audit Committee which recommends any appointment or re-appointment to the Board. This is normally undertaken through a process of competitive tendering every five years.

Policies are in place to control the amount and nature of any non-audit work performed by the external audit firm. Each year the external audit firm confirms to the Audit Committee that it considers itself to be independent as defined by the then current rules of the Institute of Chartered Accountants in England and Wales.

Remuneration Committee

This Committee of non-executive directors is chaired by Christopher Jones. The other members during the year were David Williams, Keith Brooks and Dyfrig John (from 25 September 2009). The Committee has written terms of reference which are reviewed annually. It considers remuneration policy and the Board delegates to this Committee decisions on executives' remuneration and compensation packages. The Committee monitors changing trends in directors' remuneration in the market place including consideration of the FSA Code on Remuneration Practice. In performing its duties the Committee draws on the advice of independent consultants – Hewitt New Bridge Street - who have no other connection with the Society. No individual is present at a meeting when his or her own pay is decided. Fees payable to the Chairman and other non-executive directors are determined by the Board on recommendations from the executive directors. Details of directors' remuneration are set out on page 24. The Committee reports on its activities to the Board.

Nominations Committee

The Nominations Committee is chaired by David Williams. It comprises all the non-executive directors. It has written terms of reference which are reviewed annually. The Committee is responsible for succession planning and acts as a nomination committee for all new Board appointments. The terms upon which directors are appointed are available from the Society Secretary on request. The Committee reports on its activities to the Board.

Group Risk Committee

The Group Risk Committee is chaired by Christopher Rowlands, a non-executive director. The other members of the Committee include Keith Brooks, also a non-executive director, Peter Griffiths, Guy Thomas, Graeme Yorston, Haydn Warman, Michael Jones, Director of Risk, and a number of other senior managers across the Group. The Committee has written terms of reference which are reviewed annually.

The Committee's responsibilities are as follows:

- Reviewing and recommending for Board approval the Group's Risk Appetite Statement and Risk Management Policy, including the associated sub-committee structures and the structure of delegated limits and triggers within which those sub-committees will operate;

Board and Committee membership and attendance record

	Board	Audit	Remuneration	Group Risk	Nominations
David Williams	11/11	-	6/6	-	3/3
Eurfyl ap Gwilym	10/11	-	-	-	2/3
Keith Brooks	11/11	5/5*	6/6	0/1	3/3
Langley Davies	10/11	6/6	-	-	3/3
Peter Griffiths	11/11	-	-	1/1	-
Dyfrig John (appointed 1 July 2009)	4/5	-	1/2***	-	-
Christopher Jones	11/11	-	6/6	-	3/3
Jo Kenrick	10/11	1/1**	-	-	2/3
Gordon MacLean	11/11	6/6	-	-	2/3
Christopher Rowlands (appointed 1 June 2009)	4/6****	-	-	1/1	-
Guy Thomas	11/11	-	-	1/1	-
Haydn Warman	11/11	-	-	-	-
Graeme Yorston	11/11	-	-	1/1	-

* Mr Brooks retired from the Audit Committee on 25 September 2009 and was appointed to the Group Risk Committee on 22 October 2009.
** Ms Kenrick was appointed to the Audit Committee on 25 September 2009.
*** Mr John was appointed to the Remuneration Committee on 25 September 2009.
**** Mr Rowlands was appointed to the Group Risk Committee on 25 September 2009.

The Nominations Committee meets as and when required to consider and recommend new appointments to the Board. The Group Risk Committee, formerly a management committee, was reconstituted as a Board committee in December 2009. The Commercial Lending Credit Committee meets on an ad-hoc basis to sanction significant commercial lending applications.

- Overseeing the Group Risk Registers, challenging the assessment and measurement of key risks, and monitoring the actions being taken to manage these risks;
- Reviewing the overall method by which the Group's risk appetite is determined;
- Reviewing the ICAAP framework by which the Group's existing and forecast risk positions and the resulting capital absorption are calculated and monitored;
- Reviewing and recommending the annual ICAAP for Board approval;
- Monitoring on an on-going basis the Group's actual and forecast risk and regulatory capital positions;
- Considering whether existing activities constitute appropriate utilisation of the Group's available capital;
- Recommending for Board consideration changes to capital utilisation, including utilisation of any spare capital available to the Group, or raising of additional capital as required; and
- Monitoring the performance and actions of its sub-committees, and ensuring that full coverage of all risk issues is achieved by the Group risk structure.

The Committee reports on its activities to the Board.

Commercial Lending Credit Committee

The Committee is chaired by Peter Griffiths. The members include the following directors - David Williams, Langley Davies, Keith Brooks, Dyfrig John, Christopher Rowlands and Guy Thomas – together with certain senior managers from the commercial lending division. The Committee has written terms of reference which are reviewed annually. The Committee sanctions significant commercial loan applications in accordance with a mandate approved by the Board. The Committee reports on its activities to the Board.

Copies of the Terms of Reference for each Board Committee are available on request from the Society Secretary. They can also be found on the Society's website www.principality.co.uk.

Board balance and independence

At the end of 2009 the Board comprised of a non-executive Chairman and Deputy Chairman, seven other non-executive directors and four executive directors. Each of the non-executive directors, including the Chairman, is considered by the Board to be independent in judgement and free of any relationships likely to affect his or her judgement.

The Board has appointed the Deputy Chairman as senior independent director.

The Chairman and Chief Executive

The Chairman leads the Board and is not involved in the day-to-day management of the Society. The Chairman's role profile has been approved by the Board and is reviewed annually. The Chairman does not hold any other directorships.

The Chief Executive's responsibilities are set out in a role profile approved by the Board.

Board appointments

The Nominations Committee makes recommendations for appointments to the Board. The Committee comprises only non-executive directors and is chaired by the Society Chairman.

Non-executive candidates are sought in various ways, including through press advertisements and with the assistance of external search consultants. Candidates must meet the Financial Services Authority's fitness and propriety standards. In addition, the Society's Rules require that new directors must stand for election at the Annual General Meeting in the year following the year in which they are appointed and must subsequently stand for re-election at least every three years after being first elected. A copy of the letter of appointment for a non-executive director can be obtained on request from the Society Secretary.

Information and training

The Board has full and timely access to all relevant information to enable it to discharge its duties effectively. The Chairman is responsible for ensuring that all directors are properly briefed on issues arising at Board meetings.

All directors have access to the advice and services of the Society Secretary. Members of the Board may take independent professional advice at the Society's expense in the furtherance of their duties. The Society Secretary is responsible for ensuring that Board procedures are followed.

The Society has a programme for meeting directors' training requirements. Newly appointed non-executive directors are provided with appropriate training on their role and responsibilities. Subsequent training is provided on an ongoing basis to meet particular needs.

Performance evaluation

The Chairman conducts an annual performance evaluation interview with each non-executive director and the Chief Executive. The Chief Executive carries out an annual performance appraisal with each of the other executive directors.

During 2009 the Board undertook an evaluation of the performance of the Chairman and an evaluation of its own performance. The latter was undertaken with the support of an external independent consultant who has no other connection with the Society. The Audit and Remuneration Committees each undertook a review of their own effectiveness during the year.

Communication with Members and the Annual General Meeting

The Society is committed to maintaining good communications with Members. During the year, two meetings were held by the Members' Forum as well as five Talkback sessions with groups of Members. These meetings were attended by various Society directors. These meetings provide valuable means for Members' opinions about the Society to be canvassed by directors.

The Society encourages all eligible members to participate in the Annual General Meeting, either by attending in person or by voting by proxy. A resolution on the Report on Directors' Remuneration is included on the agenda. Voting is encouraged through a donation to charity for each voting paper received. All proxy votes are returned to independent scrutineers, who also attend the meeting to count votes cast by Members in person. In accordance with the Society's Rules, all eligible Members are sent the Notice of the Annual General Meeting at least 21 days prior to the meeting.

Internal control

The Board has overall responsibility for the system of internal control and for reviewing its effectiveness. It includes financial, operational and compliance controls as well as risk management. The processes used to assess the effectiveness of the internal control system, and which have been in place throughout the year, include the following:

- Regular operational and financial reviews of performance against budgets and forecasts by management and the Board;
- Regular reviews by management and the Audit Committee of the scope and results of internal audit work across the Group. The scope of the work covers all key activities of the Group and concentrates on higher risk areas;
- Reviews by the Audit Committee of the scope of the work of the external auditors and any significant issues arising;
- Reviews by the Audit Committee and the Board of accounting policies and delegated authority levels; and
- Consideration by the Board of the major risks facing the Group and procedures to manage them.

There is an ongoing process for identifying, evaluating and managing the significant risks faced by the Group. The process currently consists of:

- Formal identification by management across the Group through a self-assessment process of the key risks to achieving their business objectives and the controls in place to manage them. The likelihood and potential impact of each risk is evaluated;
- Independent review by internal audit as to the existence and effectiveness of the risk management activities; and
- Regular review by the Board and the Group Risk Committee of perceived strategic risks.

This process has been in place throughout the year. The Group Risk Committee receives reports on the status of these risks. The Committee reports on this to the Board which in addition carries out quarterly exercises to validate management's conclusions on the major strategic risks facing the Group.

David B. Williams
Chairman
9 February 2010

Our Directors seeking election (L-R Guy Thomas, Langley Davies, Christopher Rowlands, Joanne Kenrick and Dyfrig John)

Report of the

Remuneration Committee

Remuneration principles
Principality is proud to be a mutually owned business, operated to provide benefits to its Members. Through our remuneration policy, we seek to promote the best interests of our Members and, in particular, to ensure that the business is run safely and successfully so as to keep our Members' savings safe and their other financial relationships with us secure and reliable. It follows that the two most important principles underlying our approach to remuneration, in particular of the executive directors, are:

- To set the overall remuneration at a level which is competitive but not excessive, so that we are able to attract and retain high quality people who can ensure that Principality continues to trade successfully in a highly competitive and uncertain marketplace; and

- To structure that remuneration, particularly the variable elements, in such a way that our people are incentivised and rewarded for good performance that furthers the interests of Members but does not encourage risk-taking that is excessive or in any other way inappropriate for a mutual institution.

During the year, there have been important regulatory developments, in particular the publication of the Policy Statement on Reforming Remuneration Practices in Financial Services by the Financial Services Authority (FSA) and the publication of the Walker Review of corporate governance in UK banks and other financial industry entities. Although Principality is not formally covered by the FSA's new regulations because of its size, the Committee has reviewed our approach to remuneration in the light of this guidance and, in general, found that our existing practices already satisfied most of their suggestions and requirements. However, where we were not yet fully meeting the emerging best practice, we have taken the necessary actions as described in this report, such as involving the Chief Risk Officer in the work of the Committee. Because there is already a deferral payment of two-thirds of any entitlement under the group performance bonus scheme, we believe that an appropriate part of variable remuneration remains subject to the subsequent discretion of the Committee, which would be able to take account of any dramatic change in performance over the following two years which called into question the appropriateness of the bonus entitlement.

Principality seeks to maintain high standards of corporate governance at all times. In this report, we set out information which meets the key disclosure requirements of the Combined Code on Corporate Governance.

The work of the Remuneration Committee
The Remuneration Committee is chaired by Christopher Jones and the other members are David Williams, Keith Brooks and Dyfrig John, all of whom are independent non-executive directors. The Committee met on six occasions during the year (2008: 4) to set and review the remuneration practices for the Group.

In particular the Committee reviewed the following:

- Annual pay review for executives, management and staff across the Group;

- Design of bonus schemes against targets for executives;

- Chairman's and non-executive directors' fees;

- Changing trends in director remuneration in the market place including consideration of the FSA Policy Statement on Reforming Remuneration Practices in Financial Services and the Walker Report;

- Pension provisions across the Group for executives and staff; and

- Service contracts and directors' indemnity for executive and non-executives directors.

During 2009, we revised the scheme rules for both the executive annual scheme and group performance bonus, published a Group Reward Policy and updated the Terms of Reference for the Committee, in all cases taking into account the FSA policy statement and Walker Report. Full terms of reference for the Committee can be found on the Society's website.

The Committee draws on the advice of independent external advisers if it considers this beneficial when performing its duties. This year Hewitt New Bridge Street provided benchmarking on executive remuneration packages and KPMG provided advice on pensions and forthcoming legislative changes relating to pensions and taxation. These consultants have no other connection with the Society.

Haydn Warman, Director and Secretary, acts as secretary to the Committee. The Chief Executive, Group Finance Director, Group HR Director, and the Director of Risk are invited to attend the Committee's meetings and the Committee considers their views when reviewing the remuneration of senior executives, managers and staff. They are not involved in discussions concerning their own pay.

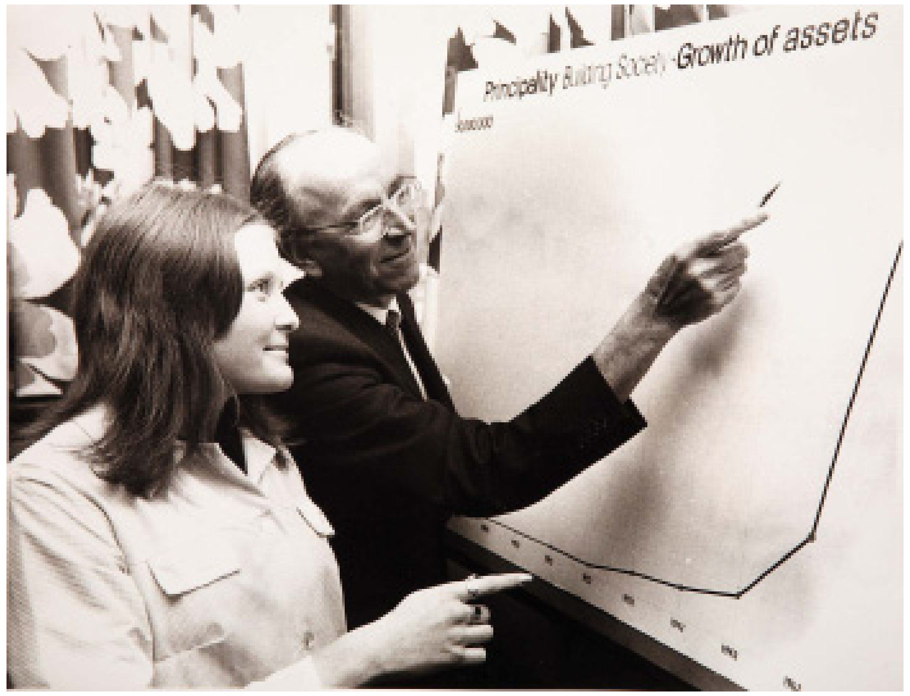
Components of Executive remuneration
There are five elements of pay for executive directors; base salary, annual bonus, group performance bonus, pension benefits and benefits in kind (details of which are set out on pages 24 and 25). Awards under bonus schemes are non-pensionable.

Base salary
Base salary determined by the Committee reflects the individual's skills, experience and performance as well as the responsibilities of the role. The Committee considers salary levels for similar roles in other companies. When determining executive salaries the Committee has regard to economic factors, remuneration trends and the general level of salary increases awarded through the Group.

Annual bonus (2009)
The annual bonus scheme provides an opportunity to reward executive directors for achieving stretching targets for the financial year. It is based on the achievement of a basket of performance targets related to financial, customer, people and process measures, together with personal objectives. To ensure affordability and to protect the interests of Members, the financial measure is a stretching profit target. The maximum bonus achievable under the annual bonus scheme is 40%.

Three executive directors, Peter Griffiths, Guy Thomas and Graeme Yorston, are eligible for annual bonus awards of 23% in respect of performance during 2009. The executive directors voluntarily waived 50% of their 2008 annual bonus award in light of the exceptional economic environment prevailing at that time.

Group performance bonus (2009)
The group performance bonus (GPB) is designed to incentivise executive directors to achieve sustained returns, in particular through the growth of profitable new business within the Group. The GPB is based on a comparison of the Group's annual performance (in terms of the post-tax return on mean assets) with that of a comparator group consisting of the largest building societies. The maximum



Demonstrating Principality's growth over the years

bonus achievable under the GPB scheme is 60%. Payment is not made if the performance falls below 90% of the average of the comparator group.

The 2009 award will be paid in three equal instalments over three years so long as the executive is still in the employment of the Society except in the case of retirement when the bonus will be paid in full. Under the Scheme rules, the second and third instalment of the 2009 award may be reduced at the discretion of the Committee.

The executive directors voluntarily waived 50% of their 2008 GPB award. Therefore, through 2010 and 2011, that element of the 2008 deferred payment is also reduced.

Since the most recent annual performance results of the comparator group will not be known until later in 2010, an amount equal to payout for average performance relative to the comparator group has been accrued for in these accounts, with an adjustment (either positive or negative) to be made by the Committee once the results for the comparator group have been published.

Non-executive directors' remuneration
The Chairman and non-executive directors do not have service contracts. They are appointed for an initial three-year period which may be extended by a maximum of two further terms.

The Chairman and non-executive directors are paid a basic fee for participation on the Society Board. The non-executives receive additional fees payable for providing services on Board committees and for their membership of subsidiary company boards.

The fees for the Chairman and non-executive directors are set by the Board on recommendations from the executive directors after reviewing the responsibilities and time involved compared with benchmark information from a comparator group comprising of other large building societies. Fees for participating on selected committees were increased during the year in recognition of the additional work involved and longer time commitments required.

Details of non-executive directors' remuneration are set out below. The Chairman and non-executive directors do not participate in any bonus schemes or any pension arrangements.

Directors’ remuneration in respect of the year to 31 December 2009

The following disclosure in this report (and the following section concerning executive directors’ pension arrangements) contains information which is audited - ‘the auditable part’.

	Salary & fees £000	Benefits £000	Annual bonus £000	Group performance bonus £000	Sub-total £000	Increase in accrued pension £000	Total £000
Executive 2009							
Peter Griffiths	296	13	71	104	484	5	489
Haydn Warman	152	13	-	53	218	3	221
Guy Thomas	196	13	45	65	319	3	322
Graeme Yorston	196	35	47	69	347	-	347
Executive remuneration total	840	74	163	291	1,368	11	1,379
Executive 2008							
Peter Griffiths	288	13	23	77	401	5	406
Haydn Warman	148	9	-	39	196	3	199
Guy Thomas	181	13	15	48	257	3	260
Graeme Yorston	186	27	14	46	273	-	273
Executive remuneration total	803	62	52	210	1,127	11	1,138

In 2008 the executive directors voluntarily waived 50% of their bonus awards. Had this not occurred, the total emoluments in 2008 would have been £1,400k compared to £1,379k in 2009.

	Salary & Fees	
	2009 £000	2008 £000
Non–Executive		
David Williams	66	64
Margaret Foster (to 18/04/08)	-	10
Eurfyl ap Gwilym	50	48
Christopher Rowlands (from 01/06/09)	18	-
Christopher Jones	32	30
Gordon MacLean	44	43
Langley Davies	46	44
Keith Brooks	34	30
Jo Kenrick (from 01/01/09)	28	-
Dyfrig John (from 01/07/09)	15	-
Sub-Total	333	269
Executive remuneration total	1,379	1,138
Total directors’ remuneration	**1,712**	**1,407**

1. The 2008 group performance bonus includes an additional £81,000 earned by executive directors in relation to the final outcome of the Scheme, payable over 3 years.
2. The 2009 GPB is based on an assumption of average performance relative to the comparator group and will be adjusted upwards or downwards to reflect actual performance once the other 2009 results are known.
3. The figures under benefits include cars, fuel, personal pension and personal medical insurance.
4. Three managers received remuneration in excess of the lowest paid executive director.

Executive directors’ service contracts

The following directors have service contracts in relation to their executive duties which provide for a twelve-month notice period or termination payment:

	Date of contract
Peter Griffiths	14/11/06
Haydn Warman	14/11/06
Guy Thomas	14/11/06
Graeme Yorston	31/12/07

Executive directors’ pension arrangements

As at 31 December 2009 executive directors listed below were members of the Society’s contributory Pension Scheme. The Scheme is a ‘career average’ scheme whereby members earn a pension of 1/60th of their salary each year, index linked to the Retail Prices Index, up to retirement age. The Scheme provides dependants’ pensions and a lump sum of four times basic salary in the event of death in service.

Information on the executive directors’ defined benefit pension arrangements is set out below:

	Accrued pension entitlement at 31/12/09 £000 pa	Increase in accrued pension during the year £000	Transfer value of accrued pension at 31/12/08 £000	Transfer value of accrued pension at 31/12/09 £000	Directors’ contributions during the year £000	Increase in transfer value over the year, net of directors’ contributions £000
Executive						
Peter Griffiths	17	5	137	241	19	61
Haydn Warman	57	3	946	1,230	10	112
Guy Thomas	16	3	172	264	12	50

Conclusion

Principality has performed very well in 2009, with profit before tax increasing by some 54%, reflecting sound management and the benefits of strategies put in place in previous years. This result has been achieved in a year of extremely challenging and uncertain market conditions, during which several of the largest building societies either ceased to trade independently or issued new capital instruments that could, in some circumstances, dilute the interests of their members. Our good trading performance has protected the interests of our Members and has enabled us to continue to provide strong member value.

The Committee recommends this report to Members for approval at our Annual General Meeting.

Christopher A. Jones
Chairman
9 February 2010

Independent

Auditors' report

to the Members of Principality Building Society

We have audited the Group and Society Annual Accounts of Principality Building Society for the year ended 31 December 2009 which comprise the Consolidated and Society Statements of Comprehensive Income, the Consolidated and Society Statement of Recognised Income and Expense, the Consolidated and Society Statements of Financial Position and the Consolidated and Society Statements of Cash Flows and the related notes. These Annual Accounts have been prepared under the accounting policies set out therein.

We have examined the Annual Business Statement (other than the details of directors and officers upon which we are not required to report) and the Directors' Report.

This report is made solely to the Society's Members, as a body, in accordance with section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's Members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's Members as a body, for our audit work, for this report or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report including the Directors' Report, the Annual Business Statement, and the Annual Accounts in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Annual Accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). We are also responsible for examining the Annual Business Statement (other than the details of directors and officers) and for reading the information in the Directors' Report and assessing whether it is consistent with the accounting records and the Annual Accounts.

We report to you our opinion as to whether the Annual Accounts give a true and fair view and whether the Annual Accounts are properly prepared in accordance with the Building Societies Act 1986, regulations made under it and, as regards the group Annual Accounts, Article 4 of the IAS Regulation. In addition, we report to you our opinion as to whether certain information in the Annual Business Statement gives a true representation of the matters in respect of which it is given, whether the information in the Directors' Report is consistent with the accounting records and the Annual Accounts and whether the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986 and regulations made under it. The information given in the Directors' Report includes that specific information given in the Chief Executive's Review that is cross referred from the Business Review section of the Directors' Report.

We also report to you if, in our opinion, the Society has not kept proper accounting records or if we have not received all the information and explanations that we require for our audit.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited Annual Accounts. The other information comprises only of the Chairman's Statement, Chief Executive's Review, Business Review and the Directors' Remuneration Report. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Annual Accounts, Annual Business Statement and Directors' Report. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Annual Accounts and the Annual Business Statement. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Annual Accounts, and of whether the accounting policies are appropriate to the Group's and Society's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Annual Accounts are free from material mis-statement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Annual Accounts.

Opinion

In our opinion:

a) the Annual Accounts give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of affairs of the Group and of the Society as at 31 December 2009 and of the income and expenditure of the Group and of the Society for the year then ended;

b) the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given;

c) the information given in the Directors' Report is consistent with the accounting records and the Annual Accounts; and

d) the Annual Accounts, the Annual Business Statement and the Directors' Report have each been prepared in accordance with the applicable requirements of the Building Societies Act 1986, regulations made under it and, as regards the group financial statements, Article 4 of the IAS Regulation.

Mark McQueen
Senior Statutory Auditor
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
Cardiff, United Kingdom
9 February 2010

Dylan at our new St. David's, Cardiff branch

Consolidated statement of comprehensive income

for the year ended 31 December 2009

	Notes	2009 £m	2008 £m
Interest receivable and similar income	4	226.7	388.6
Interest payable and similar charges	5	(120.3)	(304.0)
Net interest income		106.4	84.6
Fees and commission receivable	6	16.1	24.5
Fees and commission payable	7	(1.3)	(2.8)
Net fee and commission income		14.8	21.7
Other operating income		0.5	0.6
Other fair value (losses)/gains	8	(6.5)	3.2
Net operating income		115.2	110.1
Administrative expenses	9	(54.0)	(57.8)
Depreciation and amortisation	24 & 25	(6.0)	(6.1)
Operating expenses		(60.0)	(63.9)
Impairment provision for losses on loans and advances	21a	(39.5)	(31.7)
Financial Services Compensation Scheme levy	21b	(1.4)	(5.2)
Operating profit and profit before taxation		14.3	9.3
Taxation expense	13	(3.5)	(3.6)
Profit for the year		**10.8**	**5.7**

Consolidated statement of total recognised income and expense

for the year ended 31 December 2009

	Notes	2009 £m	2008 £m
Profit for the year		10.8	5.7
Actuarial (loss)/gain on retirement benefit obligations	12	(8.9)	0.7
Movement in deferred tax relating to retirement benefit obligations	34	2.5	(0.2)
Total recognised income for the year	**37**	**4.4**	**6.2**

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

The accounting policies and notes on pages 34 to 71 form part of these accounts.

Statement of comprehensive income of the Society

for the year ended 31 December 2009

	Notes	2009 £m	2008 £m
Interest receivable and similar income	4	181.0	368.4
Interest payable and similar charges	5	(120.3)	(304.0)
Net interest income		60.7	64.4
Fees and commission receivable	6	11.2	9.2
Fees and commission payable	7	(0.6)	(0.5)
Net fee and commission income		10.6	8.7
Other operating income		0.8	0.8
Other fair value (losses)/gains	8	(6.5)	3.2
Net operating income		65.6	77.1
Administrative expenses	9	(40.0)	(40.5)
Depreciation and amortisation	24 & 25	(4.7)	(4.6)
Operating expenses		(44.7)	(45.1)
Impairment provision for losses on loans and advances	21a	(7.0)	(3.5)
Financial Services Compensation Scheme levy	21b	(1.4)	(5.2)
Operating profit and profit before taxation		12.5	23.3
Taxation expense	13	(3.2)	(5.0)
Profit for the year		**9.3**	**18.3**

Statement of recognised income and expense of the Society

for the year ended 31 December 2009

	Notes	2009 £m	2008
Profit for the year		9.3	18.3
Actuarial (loss)/gain on retirement benefit obligations	12	(8.9)	0.7
Movement in deferred tax relating to retirement benefit obligations	34	2.5	(0.2)
Total recognised income for the year	**37**	**2.9**	**18.8**

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

The accounting policies and notes on pages 34 to 71 form part of these accounts.

Consolidated statement of financial position

at 31 December 2009

	Notes	2009 £m	2008 £m
Assets			
Liquid assets:			
Cash in hand and balances with the Bank of England		136.3	6.1
Loans and advances to credit institutions	14	159.5	195.6
Debt securities	15	1,084.5	1,180.3
		1,380.3	1,382.0
Derivative financial instruments	16	36.3	48.9
Loans and advances to customers:			
Loans fully secured on residential property	18	4,049.3	4,209.0
Other loans fully secured on land	19	594.6	588.5
Other loans	18	93.0	86.8
	20	4,736.9	4,884.3
Investment in joint venture	23	1.9	1.9
Intangible fixed assets	24	2.5	3.3
Property, plant and equipment	25	36.6	38.4
Deferred tax assets	34	3.9	1.0
Other assets	26	1.5	4.7
Prepayments and accrued income	27	19.0	34.2
Total assets		**6,218.9**	**6,398.7**
Liabilities			
Shares	28	4,933.2	4,626.4
Deposits and debt securities:			
Amounts owed to credit institutions	29	448.0	68.2
Amounts owed to other customers	30	172.6	733.9
Debt securities in issue	31	93.0	383.9
		713.6	1,186.0
Derivative financial instruments	16	50.6	70.5
Current tax liabilities		2.0	3.6
Other liabilities	32	5.8	7.3
Provisions for liabilities	21b	9.4	6.8
Accruals and deferred income	33	12.2	14.4
Deferred tax liabilities	34	1.8	2.6
Retirement benefit obligations	12	9.9	1.3
Subordinated liabilities	35	125.6	125.9
Subscribed capital	36	65.1	68.9
Total liabilities		**5,929.2**	**6,113.7**
General reserve	37	287.9	283.5
Other reserves	38	1.8	1.5
Total equity and liabilities		**6,218.9**	**6,398.7**

The accounting policies and notes on pages 34 to 71 form part of these accounts.

These accounts were approved by the Board on 9 February 2010.
Signed on behalf of the Board:

David B. Williams Chairman **Peter L. Griffiths** Chief Executive **W. Guy Thomas** Group Finance Director

Statement of financial position of the Society

at 31 December 2009

	Notes	2009 £m	2008 £m
Assets			
Liquid assets:			
Cash in hand and balances with the Bank of England		86.0	6.1
Loans and advances to credit institutions	14	208.5	194.2
Debt securities	15	1,084.5	1,180.3
		1,379.0	1,380.6
Derivative financial instruments	16	36.3	48.9
Loans and advances to customers:			
Loans fully secured on residential property	18	3,475.3	3,586.7
Other loans fully secured on land	19	594.6	588.5
	20	4,069.9	4,175.2
Investments in subsidiary undertakings	22	668.8	716.7
Investment in joint venture	23	1.9	1.9
Intangible fixed assets	24	1.8	2.5
Property, plant and equipment	25	32.5	33.6
Deferred tax assets	34	3.3	1.0
Other assets	26	1.0	1.8
Prepayments and accrued income	27	18.4	33.6
Total assets		**6,212.9**	**6,395.8**
Liabilities			
Shares	28	4,933.2	4,626.4
Deposits and debt securities:			
Amounts owed to credit institutions	29	446.4	65.4
Amounts owed to other customers	30	172.6	733.9
Debt securities in issue	31	93.0	383.9
		712.0	1,183.2
Derivative financial instruments	16	50.6	70.5
Current tax liabilities		1.8	3.6
Other liabilities	32	4.5	6.0
Provisions for liabilities	21b	5.6	6.3
Accruals and deferred income	33	11.0	12.8
Deferred tax liabilities	34	1.8	2.3
Retirement benefit obligations	12	9.9	1.3
Subordinated liabilities	35	125.6	125.9
Subscribed capital	36	65.1	68.9
Total liabilities		**5,921.1**	**6,107.2**
General reserve	37	290.0	287.1
Other reserves	38	1.8	1.5
Total equity and liabilities		**6,212.9**	**6,395.8**

The accounting policies and notes on pages 34 to 71 form part of these accounts.

These accounts were approved by the Board on 9 February 2010.
Signed on behalf of the Board:

David B. Williams Chairman **Peter L. Griffiths** Chief Executive **W. Guy Thomas** Group Finance Director

Consolidated statement of cash flows
for the year ended 31 December 2009

	2009 £m	2008 £m
Net cash inflow from operating activities (see below)	45.4	175.4
Cash flows from investing activities		
Purchase of intangible assets and property, plant and equipment	(3.5)	(5.4)
Proceeds from sale of intangible assets and property, plant and equipment	-	0.4
Purchase of investment securities	(3,475.6)	(4,298.2)
Proceeds from sale and maturity of investment securities	3,571.7	4,162.2
Purchase of shares in joint venture	-	(0.6)
Increase in cash and cash equivalents	138.0	33.8
Cash and cash equivalents at beginning of year	104.7	70.9
Cash and cash equivalents at end of year	**242.7**	**104.7**

Represented by:		
Cash and balances with the Bank of England	136.3	6.1
Loans and advances to credit institutions repayable on demand	106.4	98.6
	242.7	104.7
Net cash inflow from operating activities		
Profit before taxation	14.3	9.3
Adjusted for:		
Depreciation and amortisation	6.0	6.1
Loss on sale of property, plant and equipment	-	1.0
Increase in impairment losses on loans and advances to customers	39.4	18.8
Change in fair values	17.9	(38.9)
Other non-cash movements	0.4	6.8
Changes in net operating assets		
Decrease/(increase) in loans and advances to credit institutions	52.0	(27.2)
Decrease/(increase) in loans and advances to customers	81.4	(249.8)
Decrease in other assets	2.0	2.2
Decrease/(increase) in prepayments and accrued income	15.1	(25.9)
(Decrease)/increase in derivative financial instruments	(15.3)	30.4
Increase in shares	309.8	809.2
(Decrease) in deposits and debt securities	(471.0)	(355.3)
(Decrease) in other liabilities	(1.5)	(6.7)
Increase in accruals and deferred income	0.4	0.6
Taxation	(5.5)	(5.2)
	45.4	**175.4**

The Group is required to maintain interest-free balances with the Bank of England which at 31 December 2009 amounted to £4.4m (2008: £4.3m).

Statement of cash flows of the Society
for the year ended 31 December 2009

	2009 £m	2008 £m
Net cash inflow from operating activities (see below)	45.1	168.7
Cash flows from investing activities		
Purchase of intangible assets and property, plant and equipment	(2.9)	(3.9)
Proceeds from sale of intangible assets and property, plant and equipment	-	0.4
Purchase of investment securities	(3,475.6)	(4,298.2)
Proceeds from sale and maturity of investment securities	3,571.7	4,162.2
Purchase of shares in joint venture	-	(0.6)
Increase in cash and cash equivalents	138.3	28.6
Cash and cash equivalents at beginning of year	103.2	74.6
Cash and cash equivalents at end of year	**241.5**	**103.2**

Represented by:		
Cash and balances with the Bank of England	86.0	6.1
Loans and advances to credit institutions repayable on demand	155.5	97.1
	241.5	103.2
Net cash inflow from operating activities		
Profit before taxation	12.5	23.3
Adjusted for:		
Depreciation and amortisation	4.7	4.6
Loss on sale of property, plant and equipment	-	-
Increase in impairment losses on loans and advances to customers	7.0	3.0
Change in fair values	17.9	(38.9)
Other non-cash movements	-	0.2
Changes in net operating assets		
Decrease/(increase) in loans and advances to credit institutions	52.0	(27.2)
Decrease/(increase) in loans and advances to customers	71.8	(210.1)
Decrease/(increase) in loans to subsidiary companies	47.9	(46.6)
Decrease in other assets	0.8	2.1
Decrease/(increase) in prepayments and accrued income	15.3	(25.9)
(Decrease)/increase in derivative financial instruments	(15.3)	30.4
Increase in shares	309.8	809.2
(Decrease) in deposits and debt securities	(469.8)	(348.5)
(Decrease) in other liabilities	(1.5)	(4.8)
(Decrease)/increase in accruals and deferred income	(2.5)	2.8
Taxation	(5.4)	(4.9)
	45.1	**168.7**

Notes to the accounts

for the year ended 31 December 2009

1. Accounting policies

Basis of preparation

The Group's financial statements for the year ended 31 December 2009 have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) as adopted by the European Union and those parts of the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to Societies reporting under IFRS.

The financial statements have been prepared on a going concern basis. This is discussed in the Directors' Report on page 16, under the heading 'Going concern'.

At the date of authorisation of these financial statements the following standards and interpretations which have not been applied in these financial statements were in issue but not yet effective:

- Amendment to IFRS 8 Operating segments
- IFRS 9 Financial Instruments
- Amendments to IAS1 Presentation of Financial Statements
- Amendments to IAS7 Statement of Cash Flows
- Amendments to IAS17 Leases
- Amendments to IAS24 Related Party Disclosures
- Amendments to IAS32 Financial Instruments: Presentation
- Amendments to IAS36 Impairment of Assets
- Amendments to IAS39 Financial Instruments: Recognition and Measurement

In addition the following standards and interpretations which have not been applied in these financial statements were in issue but not effective but which have no impact on the Group:

- Amendments to IFRS1 First-time Adoption of International Financial Reporting Standards
- Amendments to IFRS2 Share-based Payments
- Amendments to IFRS5 Non-current Assets Held for Sale and Discontinued Operations

The directors anticipate that the adoption of these standards and interpretations in future periods will not have a material impact on the financial statements of the Group. The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements. IFRS 8 was adopted during the year but did not result in any changes to the operating segments.

Accounting convention

The Group prepares its accounts under the historical cost convention, except for the revaluation of debt securities - available-for-sale, certain financial assets and liabilities held at fair value and all derivative contracts.

Basis of consolidation

The Group financial statements consist of the financial statements of the ultimate parent (Principality Building Society), all entities controlled by the Society (its subsidiaries) and the Group's interests in joint ventures.

i) Subsidiaries

A subsidiary is an entity whose operating and financing policies are controlled directly or indirectly by the Society. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commenced. Intragroup balances and transactions are eliminated in preparing the consolidated financial statements.

ii) Joint ventures

A joint venture is an entity in which the Group holds an interest on a long-term basis and which is jointly controlled by the Group and one or more other venturers under a contractual agreement. Investments in joint ventures are carried in the statement of financial position at cost plus post-acquisition changes in the Group's investment.

Interest receivable and payable

Interest receivable and payable for loans and advances to customers and customer accounts are recognised in the statement of comprehensive income using the effective interest method.

The effective interest method calculates the amortised cost of a financial asset or a financial liability, and allocates the interest income or interest expense over the expected product life. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the product or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. Where calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the product (for example prepayment options) but does not consider future credit losses. The calculation includes all amounts received or paid by the Group that are an integral part of the overall return and the direct incremental transaction costs related to the acquisition or issue of a product.

Interest income on available-for-sale investments, derivatives and other financial assets accounted at fair value through the statement of comprehensive income is included in interest receivable and similar income.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Fees and commissions

Loan origination fees are reflected in the calculation of the effective interest rate on the loan. Other fees and commissions are recognised on an accruals basis when the service has been provided.

1. Accounting policies (continued)

Measurement of financial assets and liabilities

Financial assets and liabilities are classified as:

i) Loans and receivables

Loans and receivables are non-derivative fixed assets with fixed or determinable payments that are not quoted in an active market. The Group's residential and commercial mortgage loans are classified as loans and receivables and are measured at amortised cost using the effective interest method with all movements being recognised in the statement of comprehensive income.

ii) Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets, principally but not exclusively investment securities intended to be held for an indefinite period of time which may be sold in response to needs for liquidity. They are measured at fair value with changes in fair value being recognised in reserves except for impairment losses which are recognised in the statement of comprehensive income. The fair value of available-for-sale assets is derived from market data. Where this market data is not available, an independent third party provides a valuation. If the asset is sold before maturity, cumulative gains and losses recognised in reserves are recycled to the statement of comprehensive income.

iii) Held to maturity financial assets

Held to maturity financial assets are non-derivative financial assets that the Group has the ability and intention to hold to maturity. They are measured at amortised cost using the effective interest method with all movements being recognised in the statement of comprehensive income.

iv) Financial assets at fair value accounted through the statement of comprehensive income

This category consists of derivative financial assets which are held at fair value. These financial assets are initially measured at fair value with transaction costs taken directly to the statement of comprehensive income. Subsequent measurement is at fair value with changes in value reflected in the statement of comprehensive income.

v) The Group does not hold any financial assets classified as held for trading.

vi) Financial liabilities

The Group's borrowings, including Member shares, deposits, debt securities in issue and subordinated liabilities are recognised initially at fair value, being the issue proceeds net of premiums, discounts and transaction costs incurred.

Borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is adjusted for the amortisation of any transaction costs and premiums and discounts. The amortisation is recognised in interest expense and similar charges using the effective interest method.

Permanent Interest Bearing Shares (subscribed capital) which are redeemable at specific dates at the option of the Society are classified as liabilities.

Impairment losses on loans and advances to customers

The Group assesses at the date of each statement of financial position whether, as a result of one or more events that occurred after initial recognition, there is objective evidence that a financial asset or group of financial assets is impaired. Evidence of impairment may include indications that the borrower or group of borrowers are experiencing significant financial difficulty, default or delinquency in interest or principal payments or the debt being restructured to reduce the burden on the borrower.

The Group first assesses whether objective evidence of impairment exists either individually for assets that are separately significant for individual, or collectively for assets that are not separately significant. If there is no objective evidence of impairment for an individually assessed asset it is included in a group of assets with similar credit risk characteristics and collectively assessed for impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The resultant provisions have been deducted from the appropriate asset values in the statement of financial position.

The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Group to reduce any difference between loss estimates and actual loss experience.

If, in a subsequent period, the amount for the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised the provision is adjusted and the amount of the reversal is recognised in the statement of comprehensive income.

Where a loan is not recoverable, it is written off against the related provision for loan impairment once all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the statement of comprehensive income.

Loans subject to individual impairment assessment are subject to ongoing review to determine whether they remain impaired or are considered to be past due.

Derivative financial instruments and hedge accounting

The Group undertakes transactions in derivative financial instruments, which include currency swaps, interest rate swaps, interest rate caps, forward rate agreements, options, and similar instruments.

The Group's derivative activities are entered into for the purpose of matching or eliminating risk from potential movements in interest and foreign exchange rates inherent in the Group's assets, liabilities and positions. All derivative transactions are for economic hedging purposes.

Financial instruments are initially recognised at fair value.

Notes to the accounts

1. Accounting policies (continued)

i) Derivative financial instruments

Derivatives are initially measured at fair value and are subsequently remeasured to fair value at each reporting date with movements recorded in the statement of comprehensive income. Fair values are obtained from quoted prices prevailing in active markets and valuation techniques, including discounted cash flow models, as appropriate. All derivatives are classified as assets where their fair value is positive and liabilities where their fair value is negative. Where there is the legal ability and intention to settle net, then the derivative is classified as a net asset or liability, as appropriate.

ii) Embedded derivatives

Certain derivatives are embedded within other non-derivative host instruments to create a hybrid instrument. Where the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risk of the host instrument, the Group separates the embedded derivative from the host instrument and measures it at fair value with the changes in fair value recognised in the statement of comprehensive income.

iii) Hedge accounting

When transactions meet the criteria specified in IAS39, the Group applies fair value hedge accounting so that changes in the fair value of the underlying asset or liability that are attributable to the hedged risk are recorded in the statement of comprehensive income to offset the fair value movement of the related derivative.

To qualify for hedge accounting at inception the hedge relationship must be clearly documented. At inception the derivative must be expected to be highly effective in offsetting the hedged risk, and effectiveness must be tested throughout the life of the hedge relationship.

The Group discontinues hedge accounting when:

i) it is evident from testing that a derivative is not, or has ceased to be, highly effective as a hedge;

ii) the derivative expires, or is sold, terminated or exercised; or

iii) the underlying item matures or is sold or repaid.

The Group may also decide to cease hedge accounting even though the hedge relationship continues to be highly effective by ceasing to designate the financial instrument as a hedge.

If the derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedging adjustment is amortised over the period to maturity of the previously designated hedge relationship. If the underlying item is sold or repaid, the unamortised fair value adjustment is immediately reflected in the statement of comprehensive income.

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

Foreign currency translation

The consolidated financial statements are presented in Sterling which is the functional currency of the parent undertaking. Foreign currency transactions are translated into Sterling using the exchange rates prevailing at the dates of the transactions. Monetary items denominated in foreign currencies are translated at the rate prevailing at the date of the statement of financial position.

Intangible assets

i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisition of subsidiaries is included as an intangible asset. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. The impairment test compares the carrying value of goodwill to the underlying associated asset value in use. If the carrying value exceeds the value in use, goodwill is considered impaired and recognised in the statement of comprehensive income immediately.

Goodwill written off to reserves under UK GAAP prior to the introduction of FRS 10 'Goodwill and Intangible Assets' in 1998 has not been reinstated and will not be included in determining any subsequent profit or loss on disposal.

ii) Computer software

IAS38 'Intangible Assets' requires the capitalisation of certain expenditure relating to software development costs. Software development costs are capitalised if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Web costs are capitalised where the expenditure is incurred on developing an income-generating website.

Where software costs are capitalised, they are amortised using the straight-line method over their estimated useful lives which is 3 to 5 years. The amortisation periods used are reviewed annually.

Costs associated with maintaining software are expensed as they are incurred.

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences. In contrast, deferred tax assets are only recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Deferred tax related to fair value re-measurement of available-for-sale investments, which is charged or credited directly to the available-for-sale reserve, is also credited or charged directly to the available-for-sale reserve and is subsequently recognised in the statement of comprehensive income together with the deferred gain or loss.

Both current and deferred tax balances are calculated using tax rates that have been enacted or substantively enacted by the date of the statement of financial position and are expected to apply to the period when the liability is settled or the asset is realised.

Property, plant and equipment

Freehold and long leasehold properties comprise mainly branches and office buildings.

Property, plant and equipment are stated at cost less accumulated depreciation and provision for impairment, as appropriate. Additions and subsequent expenditure are included in the asset's carrying value or are recognised as a separate asset only when they improve the expected future economic benefits to be derived from the asset.

All other repairs and maintenance are charged to the statement of comprehensive income in the period in which they are incurred.

Depreciation is provided using the straight-line method to allocate costs less residual values over estimated useful lives, as follows:

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

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

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

Pension costs

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

A defined contribution scheme is one into which the Group and the employee pay fixed contributions, without any further obligation to pay further contributions. Payments into the defined contribution scheme are charged to the statement of comprehensive income as they become payable in accordance with the rules of the scheme.

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

The increase in the present value of the liabilities of the defined benefit scheme expected to arise from employee service in the period is charged to the statement of comprehensive income. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities, arising from the passage of time, are included in other operating income.

Actuarial gains and losses are recognised in full in the statement of recognised income and expense.

Leases

Leases entered into by the Group are operating leases.

(i) As lessee

Operating lease payments are charged to the statement of comprehensive income on a straight-line basis over the life of the lease.

(ii) As lessor

Lease income receivable under operating leases is credited to the statement of comprehensive income on a straight-line basis over the life of the lease.

Debt securities in issue, subordinated liabilities and Permanent Interest Bearing Shares

Premiums and discounts, together with costs associated with the issue of debt securities, subordinated liabilities and Permanent Interest Bearing Shares, are accounted for as an adjustment to the amount of the liability and amortised using the effective interest method.

Segmental reporting

A business segment is defined as a group of assets and operations providing products and services that are subject to different risks and returns from those business segments. The Group considers that business segments are its primary reporting format for segmental analysis. Business segments are based on the Group's management and internal reporting structures.

Notes to the accounts

1. Accounting policies (continued)

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash and non-restricted balances with central banks, treasury bills and other eligible bills, loans and advances to banks, other amounts due from banks and short-term government securities.

Cash held in Principality Covered Bond LLP is restricted.

Provisions and contingent liabilities

A provision is recognised when there is a present obligation as a result of a past event, it is probable that the obligation will be settled and it can be reliably estimated.

Further detail on financial commitments and contingent liabilities is described in note 39 on page 60.

Government grants

Government grants are recognised at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all the attached conditions.

Government grants are recognised as income in the statement of comprehensive income over the periods necessary to match them with the related costs to which they are intended to compensate, on a systematic basis.

Sale and repurchase agreements

Investment and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained on the balance sheet when substantially all the risks and rewards of ownership remain within the Group, and the counterparty liability is included separately on the balance sheet as appropriate.

2. Judgements in applying accounting policies and critical accounting estimates

The Group has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements. In addition, estimates and assumptions are made that could affect the reported amounts of assets and liabilities within the following financial year. The most significant areas where judgements and estimates are made are as follows:

Impairment provision on loans and advances

In accordance with the accounting policy on the impairment of financial assets carried at amortised cost where objective evidence exists that a loss has been incurred, the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

Key assumptions included in the measurement of the incurred loss include data regarding the probability of any account going into default, the probability of defaulted accounts progressing to possession and the eventual loss incurred in the event of forced sale or write-off. These assumptions are based on observed historical data and updated as management considers appropriate to reflect current and future conditions. The accuracy of the impairment provision would therefore be affected by unexpected changes in the above assumptions.

Fair value of derivatives and available-for-sale assets

Derivative financial instruments and available-for-sale assets are stated at fair value. Derivative financial instruments are valued by discounted cash flow models using yield curves that are based on observable market data. Available-for-sale assets are, in the majority of cases, valued using market prices or prices obtained from counterparties. In cases where market prices are not available, discounted cash flow models are used. Changes in the assumptions used in the models could affect the reported fair value of available-for-sale assets.

The Group applies fair value hedge accounting which relies on a number of assumptions, the most significant of which relates to estimates in respect of loan prepayments.

Retirement benefit obligations

The Group has to make assumptions on the expected return on pension plan assets, mortality inflation and future salary rises when valuing its pension liability and the cost of benefits provided. Changes in assumptions could affect the reported liability, service cost and expected return on pension plan assets.

The impact of a 0.1% increase in the inflation assumptions would be to increase the carrying value of the pension obligations by approximately £0.8m. The impact of a 0.1% increase in the discount rate would be to reduce the value of pensions obligations by approximately £0.9m. Further details on the assumptions used in valuing retirement benefit obligations can be found in note 12.

Other provisions for liabilities and charges

The Group establishes provisions for the estimated cost of making redress payments to customers in respect of past product sales or other administrative processes, in those cases where the original processes are found to have been deficient. The ultimate cost is inherently uncertain and, in determining the level of provisions required, it is necessary for management to exercise significant judgement. The principal assumptions underlying the provisions relate to the number of cases requiring redress and the estimated average cost of redress per case; these will be affected by external factors beyond the control of management, such as regulatory actions.

Taxation

Significant estimates are required in determining the provision for corporation tax. There are a number of transactions for which the final tax determination is uncertain at the date of the statement of financial position.

Effective interest rate (EIR)

The Group uses the EIR method to recognise income for certain financial instruments held at amortised cost. To calculate the appropriate EIR, the Group makes assumptions of the expected lives of financial instruments and the anticipated level of early redemption charges. The most critical assumption is the anticipated level of early redemption penalty charges.

The impact of a 10% increase/decrease in the anticipated level of early redemption would result in an increase/decrease in the value of the loans in the statement of financial position by £0.7m and (£0.7m) respectively.

Notes to the accounts

3. Business segments

The Group operates four main business segments, retail financial services, secured personal lending, estate agency and commercial lending. These segments are used for internal reporting to the Board who are responsible for all significant decisions. Transactions between the business segments are on normal commercial terms and conditions.

	2009					
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Estate agency £m	Adjustment for Group transactions £m	Total £m
Interest receivable and similar income	141.0	40.0	61.6	-	(15.9)	226.7
Interest payable and similar charges	(92.5)	(27.8)	(16.2)	-	16.2	(120.3)
Net interest income	48.5	12.2	45.4	-	0.3	106.4
Net fee and commission income	7.8	2.2	(1.9)	6.8	(0.1)	14.8
Other operating income	0.8	-	-	-	(0.3)	0.5
Fair value losses	(6.5)	-	-	-	-	(6.5)
Net operating income	**50.6**	**14.4**	**43.5**	**6.8**	**(0.1)**	**115.2**
Administrative expenses	(43.1)	(2.0)	(8.7)	(6.2)	-	(60.0)
Impairment provision for losses on loans and advances	(2.0)	(5.0)	(32.5)	-	-	(39.5)
Financial Services Compensation Scheme levy	(1.4)	-	-	-	-	(1.4)
Operating profit/(loss) and profit/(loss) before taxation	**4.1**	**7.4**	**2.3**	**0.6**	**(0.1)**	**14.3**

	2008					
	Retail financial services £m	Commercial lending £m	Secured personal lending £m	Estate agency £m	Adjustment for Group transactions £m	Total £m
Interest receivable and similar income	362.4	62.5	62.0	-	(98.3)	388.6
Interest payable and similar charges	(304.0)	(55.6)	(42.7)	-	98.3	(304.0)
Net interest income	58.4	6.9	19.3	-	-	84.6
Net fee and commission income	6.1	1.0	6.2	8.5	(0.1)	21.7
Other operating income	0.6	-	-	-	-	0.6
Fair value gains	3.2	-	-	-	-	3.2
Net operating income	**68.3**	**7.9**	**25.5**	**8.5**	**(0.1)**	**110.1**
Administrative expenses	(42.7)	(1.7)	(11.8)	(9.8)	2.1	(63.9)
Impairment provision for losses on loans and advances	(1.3)	(2.2)	(28.2)	-	-	(31.7)
Financial Services Compensation Scheme levy	(5.2)	-	-	-	-	(5.2)
Operating profit/(loss) and profit/(loss) before taxation	**19.1**	**4.0**	**(14.5)**	**(1.3)**	**2.0**	**9.3**

Notes to the accounts

3. Business segments (continued)

	Group	
	2009 £m	2008 £m
Total assets by business segment		
Retail financial services	4,575.9	4,723.3
Secured personal lending	669.7	714.4
Commercial lending	968.5	956.8
Estate agency	4.8	4.2
Total assets	**6,218.9**	**6,398.7**
Total liabilities by business segment		
Retail financial services	5,544.4	5,680.1
Secured personal lending	669.7	714.4
Commercial lending	-	-
Estate agency	4.8	4.2
Total liabilities	**6,218.9**	**6,398.7**

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

4. Interest receivable and similar income

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
On loans fully secured on residential property	226.6	269.6	164.7	206.7
On other loans fully secured on land	24.4	37.1	24.4	37.1
On other loans to subsidiaries	-	-	16.2	42.7
On debt securities	23.1	68.4	23.1	68.4
Profit on realisation of investments	3.7	0.2	3.7	0.2
On other liquid assets	1.2	5.4	1.2	5.4
On derivative financial instruments	(52.3)	7.9	(52.3)	7.9
	226.7	**388.6**	**181.0**	**368.4**

Notes to the accounts

5. Interest payable and similar charges

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
On shares held by individuals	112.5	202.5	112.5	202.5
On other shares	-	0.3	-	0.3
On deposits and debt securities	23.0	89.4	23.0	89.4
On subscribed capital	4.2	4.5	4.2	4.5
On subordinated liabilities	6.5	6.5	6.5	6.5
On derivative financial instruments	(25.9)	0.8	(25.9)	0.8
	120.3	**304.0**	**120.3**	**304.0**

6. Fees and commission receivable

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Insurance and related financial service products	3.5	11.8	5.8	4.1
Estate agency	4.5	5.2	-	-
Mortgage related fees	5.3	5.2	4.2	3.6
Other fees and commission	2.8	2.3	1.2	1.5
	16.1	**24.5**	**11.2**	**9.2**

7. Fees and commission payable

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Mortgage related fees	1.0	2.5	0.3	0.2
Bank charges	0.3	0.3	0.3	0.3
	1.3	**2.8**	**0.6**	**0.5**

Notes to the accounts

8. Other fair value gains and losses

	Group and Society	
	2009 £m	2008 £m
Gains/(losses) on derivatives	7.3	(22.5)
(Losses)/gains on hedged items attributable to the hedged risk	(13.8)	25.7
	(6.5)	3.2

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.

On an on-going basis, management review the appropriateness of assumptions used to calculate the fair value adjustments to hedged risk. During 2009, management has revised their estimates relating to the fair value adjustments. This resulted in a £3.8m charge which is included within the £13.8m loss shown above.

9. Administrative expenses

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Wages and salaries	28.7	30.0	21.7	19.9
Social security costs	2.7	3.1	2.1	2.0
Other pension costs	1.1	1.3	1.0	1.1
	32.5	34.4	24.8	23.0
Other administrative expenses	21.5	23.4	15.2	17.5
	54.0	57.8	40.0	40.5

Other administrative expenses include:	£000	£000	£000	£000
Auditors' remuneration:				
For audit of the Society's Annual Accounts	99	115	99	115
For other services:				
For audit of the Society's subsidiaries	25	20	-	-
Tax advisory	117	42	47	38
Further assurance services	102	75	172	45
All other services	10	54	10	49
Operating lease charges - motor vehicles	272	379	241	321
- land and buildings	1,725	1,817	709	641

Notes to the accounts

10. Employees

The average number employed including executive directors was:

	Full-time		Part-time	
	2009 Number	2008 Number	2009 Number	2008 Number
Society's Customer Support Centre	414	390	65	58
Society branch offices	186	182	98	78
Employed by the Society	600	572	163	136
Subsidiaries	238	242	48	47
Employed by the Group	838	814	211	183

11. Emoluments of the Society's Directors

Directors' emoluments are shown as part of the Report of the Remuneration Committee on pages 22 to 25 in accordance with Schedule 5, paragraphs 4 and 5 to the Building Societies (Accounts and Related Provisions) Regulations 1998. Total directors' emoluments for the year were £1.7m (2008: £1.4m).

In addition, pensions amounting to £23k (2008: £22k) were paid to former directors.

12. Retirement benefit obligations

The Group operates two pension schemes, a defined contribution scheme and a defined benefit scheme. A defined contribution scheme is one into which the Group and the employee pay fixed contributions, without any further obligation to pay further contributions. Staff employed after 1 January 2001 are eligible to join this scheme. The cost to the Group and Society of employer's contributions to the scheme in 2009 was £200k (2008: £219k). There were no contributions outstanding or prepaid at the end of the year.

A defined benefit scheme is one that defines the benefit an employee will receive on retirement, depending on such factors as age, length of service and salary. Staff, including executive directors, who entered service before 1 January 2001 were eligible to join the Society's Defined Benefit Scheme which is designed to provide pension entitlements based on career average salary (final salary until 31 December 2005) with assets held outside the Society in a separate fund administered by the Trustees. Membership of the Scheme is however available at the discretion of the Society and a small number of new Members have been admitted to the Scheme on this basis subsequent to 1 January 2001. The Defined Benefit Scheme was subject to a triennial valuation by the Scheme's independent actuary on 30 September 2007, at which date there was a surplus of £0.1m. This valuation was approved by the Trustees on 22 December 2008.

Scheme management consists of a Board of Trustees, comprising five individuals, two of which were elected by the Members to the Board of Trustees as Member Nominated Trustees. The power of appointment and removal of the Trustees is vested in the Society in accordance with the Trust Deed.

The Trustees have continued to act in accordance with the Statement of Investment Principles adopted on 1 November 2007 as required by s.35 of the Pensions Act 1995. The Scheme assets are currently invested in the Targeted Return Fund managed by UBS Global Assets Management, the Target Return Fund with BlackRock Investment Management (UK) Limited and the UK Aggregate Bond Pension Fund with Royal London Asset Management. In addition the Trustees may hold cash from time to time.

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

Updated calculations prepared by the scheme actuary on the IAS19 basis at 31 December 2009, including the unfunded liability referred to above, revealed a deficit amounting to £9.9m (2008: £1.3m).

12. Retirement benefit obligations (continued)

The major assumptions used by the actuary were:

	At 31 December				
	2009 %	2008 %	2007 %	2006 %	2005 %
Rate of increase in pensionable salaries	3.60	2.70	3.20	2.75	2.60
Rate of increase of pensions in payment and deferred pensions	3.60	2.70	3.20	2.75	2.60
Discount rate	5.65	6.25	5.70	5.10	4.70
Inflation assumption	3.60	2.70	3.20	2.75	2.60
The long-term rates of return expected on investments in the schemes were:	6.50	6.50	6.50	6.00	6.00

The assumptions on mortality are determined by the following tables:

	2009	2008
Retired and non-retired members	PA92 MCB	PA92 MCB
The assumptions are illustrated by the following year of life expectancy at age 65:		
Retired members		
Males currently aged 65	22.0	22.0
Females currently aged 65	24.9	24.8
Non-retired members		
Males currently aged 45	23.1	23.1
Females currently aged 45	25.9	25.9

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

	At 31 December				
	2009 £m	2008 £m	2007 £m	2006 £m	2005 £m
Target return funds	18.6	17.8	21.5	-	-
Debt securities	21.4	17.7	17.6	-	-
Equities	-	-	-	19.1	17.6
Bonds and cash	0.4	-	-	18.3	17.5
Total fair value of plan assets	40.4	35.5	39.1	37.4	35.1
Present value of funded obligations	(49.8)	(36.3)	(40.5)	(37.4)	(36.7)
Present value of unfunded obligations	(0.5)	(0.5)	(0.5)	(0.6)	(0.6)
Net deficit recognised in the statement of financial position	**(9.9)**	**(1.3)**	**(1.9)**	**(0.6)**	**(2.2)**

12. Retirement benefit obligations (continued)

The amounts recognised in the statement of comprehensive income are as follows:

	Group and Society	
	2009 £m	2008 £m
Analysis of pension costs (included in administrative expenses)		
Current service cost	(0.7)	(1.1)
	(0.7)	**(1.1)**
Analysis of finance credit (included in other operating income)		
Expected return on pension scheme assets	2.3	2.5
Interest on pension scheme liabilities	(2.3)	(2.4)
Net credit to other financial income	**-**	**0.1**
Analysis of amount recognised in statement of total recognised income and expense		
Actuarial (loss)/gain	**(8.9)**	**0.7**
Analysis of the movement in the Statement of Financial Position deficit		
Deficit in schemes at beginning of year	(1.3)	(1.9)
Movement in year:		
Current service cost	(0.7)	(1.1)
Other finance credit	-	0.1
Actuarial (loss)/gain	(8.9)	0.7
Contributions paid	1.0	0.9
Deficit in schemes at end of year	**(9.9)**	**(1.3)**

	Group and Society				
Details of experience gains and losses	**2009**	**2008**	**2007**	**2006**	**2005**
Difference between the expected and actual return on scheme assets:					
Gain/(loss) amount	£2.8m	(£6.2m)	(£0.7m)	(£0.1m)	£3.3m
Percentage of scheme assets	6.9%	17.5%	1.8%	0.1%	9.3%
Experience gains and losses on scheme liabilities:					
(Loss)/gain amount	(£11.6m)	£6.9m	(£0.8m)	-	£2.3m
Percentage of the present value of scheme liabilities	23.0%	18.8%	1.9%	-	6.2%
Total amount recognised in statement of total recognised income and expense:					
(Loss)/gain amount	(£8.8m)	£0.7m	(£1.5m)	£1.6m	£5.0m
Percentage of the present value of scheme liabilities	17.5%	1.8%	3.7%	4.1%	13.6%

The actual return on plan assets was £2.3m (2008: £3.6m loss).

The Group estimates that its contributions to the defined benefit scheme during the year ending 31 December 2010 will be £1.3m.

Notes to the accounts

13. Taxation

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Current tax				
UK corporation tax charge for the year	5.4	4.3	3.6	4.3
Adjustments in respect of prior years	(0.6)	(1.5)	(0.1)	0.2
	4.8	2.8	3.5	4.5
Deferred tax				
Deferred tax (credit)/charge for year	(1.0)	0.6	(0.3)	0.5
Adjustments in respect of prior years	(0.3)	0.2	-	-
	(1.3)	0.8	(0.3)	0.5
Taxation on profit on ordinary activities	**3.5**	**3.6**	**3.2**	**5.0**

The statutory rate of corporation tax was reduced to 28% from 1 April 2008. The Group was subject to corporation tax at a rate of 30% for the period 1 January to 31 March 2008, and 28% for the period 1 April to 31 December 2008, resulting in an effective rate of corporation tax of 28.5% for the full year in 2008.

The actual tax charge for the year differs from that calculated using the standard rate of corporation tax in the UK. The differences are explained below.

	Group 2009 £m	Group 2008 £m	Society 2009 £m	Society 2008 £m
Profit before taxation	14.3	9.3	12.5	23.3
Profit multiplied by the standard rate of corporation tax in the UK at 28.0% (2008: 28.5%)	4.0	2.6	3.5	6.6
Effects of:				
Group relief received for nil consideration	-	-	-	(2.8)
Depreciation in excess of capital allowances	-	0.3	-	0.2
Expenses not deductible for tax purposes	0.3	0.2	0.2	0.1
Adjustments to prior years	(0.9)	(1.3)	(0.1)	0.2
Write-off of connected party loan	-	-	-	0.7
Tax losses carried back	-	1.7	-	-
Other	0.1	0.1	(0.4)	-
Total taxation for the year	**3.5**	**3.6**	**3.2**	**5.0**

14. Loans and advances to credit institutions

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Repayable from the date of the statement of financial position in the ordinary course of business:				
Accrued interest	0.1	-	0.1	-
On demand	93.9	98.5	142.9	97.1
Less than three months	53.0	105.1	53.0	105.1
Credit Support Annex (CSA) asset/(liability)	12.5	(8.0)	12.5	(8.0)
	159.5	**195.6**	**208.5**	**194.2**

The International Swaps and Derivatives Association (ISDA) Master Agreement is Principality's preferred agreement for documenting derivative activity. For certain counterparties a Credit Support Annex (CSA) has been executed in conjunction with the ISDA Master Agreement. Under a CSA, collateral is passed between counterparties to mitigate the market contingent counterparty risk inherent in the outstanding positions. £12.5m has been pledged during the year (2008: £8.0m deposited).

CSA liability of £8.0m in 2008 has been reclassified from 'Derivative Financial Instruments' to 'Loans and advances to credit institutions' in the year. There was no effect on the opening balance sheet at 1 January 2008 as a result of this reclassification.

Notes to the accounts

15. Debt securities

	Group and Society	
	2009 £m	2008 £m
Issued by UK government	508.2	251.7
Issued by other borrowers and unlisted	576.3	928.6
	1,084.5	**1,180.3**

Debt securities are held as available-for-sale assets and carried at their fair value.

The debt securities set out above are repayable from the date of the statement of financial position in the ordinary course of business as follows:

	Group and Society	
	2009 £m	2008 £m
Accrued interest	4.9	14.3
Less than three months	275.0	615.8
Between three months and one year	208.9	198.6
Between one year and five years	595.7	351.6
	1,084.5	**1,180.3**

The movement in available-for-sale debt securities is summarised as follows:

	Group and Society £m
At 1 January 2009	1,180.3
Additions	3,475.6
Disposals and maturities	(3,562.3)
Gains from changes in fair value	0.3
Decrease in accrued interest	(9.4)
At 31 December 2009	**1,084.5**

The Society engages in gilt stock lending controlled through the Central Gilt Office of the Bank of England.

16. Derivative financial instruments

Currency and interest rate swaps are used by the Group for hedging purposes. These are commitments to exchange one set of cash flows for another. No exchange of principal takes place.

	Group and Society			
	Contract/ notional amount		Fair value	
	2009 £m	2008 £m	2009 £m	2008 £m
Derivative assets held for hedging purposes and designated fair value hedges:				
Interest rate swaps	1,639.1	1,399.3	24.1	32.7
Cross currency interest rate swaps	53.3	57.3	12.2	16.2
Total recognised derivative assets	**1,692.4**	**1,456.6**	**36.3**	**48.9**
Derivative liabilities held for hedging purposes and designated fair value hedges:				
Interest rate swaps	1,653.6	1,626.9	(50.6)	(70.5)
Total recognised derivative assets/(liabilities)	**1,653.6**	**1,626.9**	**(50.6)**	**(70.5)**

17. Assets measured at fair value

	Group and Society			
	2009 £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	36.3	-	36.3	-
Available-for-sale financial assets:				
Debt securities	1,084.5	1,084.5	-	-
Total	**1,120.8**	**1,084.5**	**36.3**	**-**

	Group and Society			
	2008 £m	Level 1 £m	Level 2 £m	Level 3 £m
Financial assets at fair value through profit or loss:				
Derivative financial instruments	40.9	-	40.9	-
Available-for-sale financial assets:				
Debt securities	1,180.3	1,170.3	10.0	-
Total	**1,221.2**	**1,170.3**	**50.9**	**-**

Level	Hierarchy for fair value disclosures
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.

18. Loans fully secured on residential property

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Gross balances	4,105.2	4,216.0	3,441.9	3,525.9
Provision for impairment losses	(49.3)	(38.3)	(12.5)	(12.3)
Unamortised loan origination fees	38.0	43.1	(2.5)	(1.9)
Fair value adjustment for hedged risk	48.4	75.0	48.4	75.0
	4,142.3	**4,295.8**	**3,475.3**	**3,586.7**

Within the Group totals above there was £93.0m partially secured against residential property (2008: £86.8m).

19. Other loans fully secured on land

	Group and Society	
	2009 £m	2008 £m
Other loans	594.6	588.5

20. Loans and advances to customers

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Maturity analysis of loans and advances to customers from the date of the statement of financial position:				
Repayable on demand	66.4	41.7	62.6	41.7
Less than three months	110.2	104.3	102.2	104.3
Between three months and one year	218.5	225.1	193.7	225.1
Between one year and five years	1,071.7	932.7	922.1	910.0
More than five years	3,233.0	3,500.7	2,755.9	2,833.3
	4,699.8	4,804.5	4,036.5	4,114.4
Provision for impairment losses	(49.3)	(38.3)	(12.5)	(12.3)
Unamortised loan origination fees	38.0	43.1	(2.5)	(1.9)
Fair value adjustment for hedged risk	48.4	75.0	48.4	75.0
	4,736.9	**4,884.3**	**4,069.9**	**4,175.2**

On 22 January 2009, the Group entered into a Covered Bond Programme. The Programme involved the formation of Principality Covered Bond LLP, a Limited Liability Partnership which is consolidated into the accounts of the Group. The LLP provides security to issues of covered bonds made by the Society as part of the Covered Bond Programme.

As at 31 December 2009, £834.1m of loans issued by the Society had been transferred to Principality Covered Bond LLP. These loans secure a £700m AAA rated bond issued internally by the Society. The loans remain on the balance sheet of the Society as the risks and rewards are retained by the Society.

21a. Provision for impairment losses

	Loans fully secured on residential property	
	2009 £m	2008 £m
Group		
At 1 January	38.3	19.4
Amounts written off during the year	(28.5)	(12.8)
Provision for loan impairment	39.5	31.7
At 31 December	**49.3**	**38.3**
Society		
At 1 January	12.3	9.3
Amounts written off during the year	(6.8)	(0.5)
Provision for loan impairment	7.0	3.5
At 31 December	**12.5**	**12.3**

21b. Provisions for liabilities

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
At 1 January	6.8	2.0	6.3	2.0
Additions	4.7	5.2	1.4	5.2
Utilisation	(1.6)	-	(1.6)	-
Release for the year	(0.5)	(0.4)	(0.5)	(0.9)
At 31 December	**9.4**	**6.8**	**5.6**	**6.3**

Included in provisions is the Financial Services Compensation Scheme levy of £5.0m which is based on the Group's share of protected deposits and represents the expected charge to March 2011. £1.6m was paid in September 2009, representing the first instalment of the levy. The contingent aspect of the levy is described in note 39 on page 60.

22. Investments in subsidiary undertakings

	Society	
	2009 £m	2008 £m
Shares in subsidiary undertakings:		
At cost	4.5	4.5
Amounts written off investments	(3.4)	(3.0)
	1.1	1.5
Loans to subsidiary undertakings	667.7	715.2
	668.8	**716.7**

	Subsidiary undertakings	
	Shares £m	Loans £m
Movement in investments in subsidiary undertakings:		
At 1 January 2009	1.5	715.2
Decrease	(0.4)	(47.5)
At 31 December 2009	**1.1**	**667.7**

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

The Society has the following subsidiary undertakings which operated in the United Kingdom during the year and are included in the Group accounts:

	Place of registration	Principal activity	Class of shares held	Interest of Society	Direct or indirect
Peter Alan Limited	England and Wales	Estate agency and financial services	Ordinary and preference	100%	Direct
Nemo Personal Finance Limited	England and Wales	Secured personal lending	Ordinary	100%	Direct
Loan Link Limited	England and Wales	Loan broking	Ordinary	100%	Indirect
Principality Mortgage and Insurance Services Limited	England and Wales	Provision of advisory and administration services	Ordinary	100%	Direct
Principality Covered Bond LLP	England and Wales	Provision of security for issued Covered Bonds	Ordinary	100%	Direct

The Society also holds 100% of the ordinary share capital of the following subsidiary undertakings which have not carried on business during the year:

Brokerpoint Limited
Home Information Pack Wales Limited
Nemo Loans Limited
Nemo Financial Limited
Nemo Financial Services Limited
Nemo Secured Loans Limited
Nemo Insurance Services Limited
Principality Limited
Principality Asset Management Limited
Principality Bank Limited
Principality Direct Limited
Principality Estate Agency Limited
Principality Financial Management Limited
Principality Homes Limited
Principality (IFA Services) Limited
Principality Independent Financial Advisers Limited
Principality Life Assurance Services Limited
Principality (Life and Pensions) Limited
Principality Mortgage Corporation Limited
Principality Personal Loans Limited
Principality Property Sales Limited
Principality Property Services Limited
Principality Surveyors Home Condition Report Limited
Principality Syndicated Loans Limited
The Principality Home Information Pack Limited
Friary Two Limited

23. Investment in joint venture

The Group has the following joint venture which operated in the United Kingdom during the year and is included in the Group accounts:

	Place of registration	Principal activity	Class of shares held	Interest of Society	Direct or indirect
Friary One Limited	England and Wales	Property Investment	Ordinary	50%	Direct

The aggregate movement in investment in joint venture is as follows:

	Group and Society £m
At 1 January and 31 December 2009	1.9

There were no contingent assets, liabilities or capital commitments at the year end.

24. Intangible assets

2009	Goodwill		Computer software		Total	
	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m
Cost:						
At 1 January 2009	0.7	-	4.7	4.3	5.4	4.3
Additions	-	-	0.1	0.1	0.1	0.1
Reclassifications	-	-	(0.4)	-	(0.4)	-
Disposals	-	-	-	-	-	-
At 31 December 2009	**0.7**	**-**	**4.4**	**4.4**	**5.1**	**4.4**
Amortisation:						
At 1 January 2009	-	-	2.1	1.8	2.1	1.8
Reclassifications	-	-	(0.3)	-	(0.3)	-
Charge for the year	-	-	0.8	0.8	0.8	0.8
Disposals	-	-	-	-	-	-
At 31 December 2009	**-**	**-**	**2.6**	**2.6**	**2.6**	**2.6**
Net carrying amount:						
At 31 December 2009	**0.7**	**-**	**1.8**	**1.8**	**2.5**	**1.8**
At 31 December 2008	0.7	-	2.6	2.5	3.3	2.5

£0.4m of software licences were reclassified to fixed assets in the year.

24. Intangible assets (continued)

2008	Goodwill		Computer software		Total	
	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m
Cost:						
At 1 January 2008	0.7	-	4.9	3.6	5.6	3.6
Additions	-	-	0.7	0.7	0.7	0.7
Disposals	-	-	(0.9)	-	(0.9)	-
At 31 December 2008	**0.7**	**-**	**4.7**	**4.3**	**5.4**	**4.3**
Amortisation:						
At 1 January 2008	-	-	1.6	1.0	1.6	1.0
Charge for the year	-	-	0.9	0.8	0.9	0.8
Disposals	-	-	(0.4)	-	(0.4)	-
At 31 December 2008	**-**	**-**	**2.1**	**1.8**	**2.1**	**1.8**
Net carrying amount:						
At 31 December 2008	**0.7**	**-**	**2.6**	**2.5**	**3.3**	**2.5**
At 31 December 2007	0.7	-	3.3	2.6	4.0	2.6

The goodwill arises following the acquisition of 100% of the ordinary share capital of Loan Link Limited on 1 December 2004.

In accordance with the requirements of IAS36, the Group completed an impairment review of the carrying value for goodwill as at 31 December 2009 to ensure that the carrying value is stated at no more than its recoverable amount. No impairment provision is required as a result of this review.

25. Property, plant and equipment

	Land and buildings		Equipment, fixtures, fittings & vehicles		Total	
	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m
Cost:						
At 1 January 2009	45.9	42.1	24.1	16.8	70.0	58.9
Additions	0.8	0.7	2.6	2.1	3.4	2.8
Reclassifications	-	-	0.4	-	0.4	-
Disposals	-	-	(1.6)	(1.5)	(1.6)	(1.5)
At 31 December 2009	**46.7**	**42.8**	**25.5**	**17.4**	**72.2**	**60.2**
Depreciation:						
At 1 January 2009	16.6	15.0	15.0	10.3	31.6	25.3
Charge for the year	1.7	1.6	3.6	2.3	5.3	3.9
Reclassifications	-	-	0.3	-	0.3	-
Disposals	-	-	(1.6)	(1.5)	(1.6)	(1.5)
At 31 December 2009	**18.3**	**16.6**	**17.3**	**11.1**	**35.6**	**27.7**
Net book amount:						
At 31 December 2009	**28.4**	**26.2**	**8.2**	**6.3**	**36.6**	**32.5**
At 31 December 2008	29.3	27.1	9.1	6.5	38.4	33.6

	2009		2008	
Land and buildings:	Group £m	Society £m	Group £m	Society £m
Freehold	25.2	23.6	26.2	24.6
Long leasehold	0.7	0.6	0.6	0.3
Short leasehold	2.5	2.0	2.5	2.2
	28.4	**26.2**	**29.3**	**27.1**
Occupied by the Society and subsidiary undertakings	26.9	25.2	24.1	23.0

	Land and buildings		Equipment, fixtures, fittings & vehicles		Total	
	Group £m	Society £m	Group £m	Society £m	Group £m	Society £m
Cost:						
At 1 January 2008	46.2	42.4	21.1	14.7	67.3	57.1
Additions	0.4	0.3	4.3	2.9	4.7	3.2
Disposals	(0.7)	(0.6)	(1.3)	(0.8)	(2.0)	(1.4)
At 31 December 2008	**45.9**	**42.1**	**24.1**	**16.8**	**70.0**	**58.9**
Depreciation:						
At 1 January 2008	15.2	13.8	12.3	8.8	27.5	22.6
Charge for the year	1.7	1.5	3.5	2.3	5.2	3.8
Disposals	(0.3)	(0.3)	(0.8)	(0.8)	(1.1)	(1.1)
At 31 December 2008	**16.6**	**15.0**	**15.0**	**10.3**	**31.6**	**25.3**
Net book amount:						
At 31 December 2008	**29.3**	**27.1**	**9.1**	**6.5**	**38.4**	**33.6**
At 31 December 2007	31.0	28.6	8.8	5.9	39.8	34.5

Notes to the accounts

26. Other assets

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Due within one year:				
Other	1.5	4.7	1.0	1.8

£4.0m of other liabilities has been reclassified to other assets during the year.

27. Prepayments and accrued income

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Accrued interest on derivative financial instruments	15.5	31.1	15.5	31.1
Other accrued interest	-	0.1	-	0.1
Other	3.5	3.0	2.9	2.4
	19.0	**34.2**	**18.4**	**33.6**

28. Shares

	Group and Society	
	2009 £m	2008 £m
Held by individuals	4,915.2	4,602.0
Other shares	6.6	10.0
Fair value adjustment for hedged risk	11.4	14.4
	4,933.2	**4,626.4**

The repayment of the above balances from the date of the statement of financial position in the ordinary course of business is as follows:

	Group and Society	
	2009 £m	2008 £m
Fair value adjustment for hedged risk	11.4	14.4
Accrued interest	63.0	138.7
On demand	1,361.3	1,895.4
Less than three months	1,215.0	1,395.4
Between three months and one year	1,107.1	856.5
Between one year and five years	1,175.4	326.0
	4,933.2	**4,626.4**

29. Amounts owed to credit institutions

The repayment from the date of the statement of financial position in the ordinary course of business is as follows:

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Accrued interest	0.3	0.2	0.3	0.2
On demand	59.3	2.8	57.7	-
Less than three months	137.5	65.2	137.5	65.2
Between three months and one year	250.9	-	250.9	-
	448.0	**68.2**	**446.4**	**65.4**

30. Amounts owed to other customers

The repayment from the date of the statement of financial position in the ordinary course of business is as follows:

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Accrued interest	2.4	14.0	2.4	14.0
On demand	24.0	5.5	24.0	5.5
Less than three months	103.0	413.1	103.0	413.1
Between three months and one year	43.2	263.8	43.2	263.8
Between one year and five years	-	37.5	-	37.5
	172.6	**733.9**	**172.6**	**733.9**

31. Debt securities in issue

	Group and Society	
	2009 £m	2008 £m
Certificates of deposit	14.0	98.5
Fixed and floating rate notes	78.3	283.5
Fair value adjustment for hedged risk	0.7	1.9
	93.0	**383.9**

The repayment from the date of the statement of financial position in the ordinary course of business is as follows:

	Group and Society	
	2009 £m	2008 £m
Fair value adjustment for hedged risk	0.7	1.9
Accrued interest	0.1	3.2
Less than three months	9.0	83.5
Between three months and one year	29.9	213.0
Between one year and five years	53.3	63.2
More than five years	-	19.1
	93.0	**383.9**

31. Debt securities in issue (continued)

The effective interest rates at the balance sheet dates were as follows:

	Group and Society	
	2009 £m	2008 £m
Certificates of deposit	1.61%	5.63%
Fixed and floating rate notes	0.74%	4.14%

32. Other liabilities

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Due within one year:				
Income tax	0.3	0.7	0.3	0.6
Other taxation and social security	0.9	1.3	0.7	1.2
Other creditors	4.6	5.3	3.5	4.2
	5.8	**7.3**	**4.5**	**6.0**
Other creditors include amounts due to subsidiary undertakings			-	0.3

£4.0m of other liabilities has been reclassified to other assets during the year.

33. Accruals and deferred income

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Interest accrued on subordinated liabilities	3.1	3.6	3.1	3.6
Interest accrued on subscribed capital	0.4	1.2	0.4	1.2
Other	8.7	9.6	7.5	8.0
	12.2	**14.4**	**11.0**	**12.8**

34. Deferred tax

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
At 1 January	1.7	0.7	1.3	0.5
Charged to the statement of comprehensive income	(1.3)	0.8	(0.3)	0.6
Charged to statement of recognised income and expense on actuarial (losses)/gains	(2.5)	0.2	(2.5)	0.2
At 31 December	**(2.1)**	**1.7**	**(1.5)**	**1.3**

Notes to the accounts

34. Deferred tax (continued)

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

	Group			Society		
	Retirement benefit obligations	Other	Total	Retirement benefit obligations	Other	Total
	£m	£m	£m	£m	£m	£m
Deferred tax assets						
At 1 January 2009	(0.3)	(0.7)	(1.0)	(0.3)	(0.7)	(1.0)
Credited to the statement of comprehensive income	-	(0.4)	(0.4)	-	0.2	0.2
Charged to statement of recognised income and expense	(2.5)	-	(2.5)	(2.5)	-	(2.5)
At 31 December 2009	**(2.8)**	**(1.1)**	**(3.9)**	**(2.8)**	**(0.5)**	**(3.3)**

	Group			Society		
	Accelerated tax depreciation	Other	Total	Accelerated tax depreciation	Other	Total
	£m	£m	£m	£m	£m	£m
Deferred tax liabilities						
At 1 January 2009	0.9	1.8	2.7	0.6	1.7	2.3
Credited to the statement of comprehensive income	(0.3)	(0.6)	(0.9)	(0.2)	(0.3)	(0.5)
At 31 December 2009	**0.6**	**1.2**	**1.8**	**0.4**	**1.4**	**1.8**

35. Subordinated liabilities

	Group and Society	
	2009 £m	2008 £m
$5^3/_8$% Subordinated Notes due 2016	120.0	120.0
Unamortised premiums and issue costs	(0.3)	(0.5)
Fair value adjustment for hedged risk	5.9	6.4
	125.6	**125.9**

The Society's subordinated liabilities are unsecured. The Society may, with prior consent of the Financial Services Authority, redeem all of the subordinated notes at par on 8 July 2011 by giving not less than 15 nor more than 30 days' notice to all holders. In the event that the Society does not redeem the notes on 8 July 2011, the rate of interest will become LIBOR plus 1.005% reset quarterly.

The subordinated notes rank pari passu with each other and behind the claims against the Society of all depositors, creditors and investing Members of the Society.

The interest rate risk arising from the issue of fixed rate subordinated debt has been mitigated through the use of interest rate swaps.

On 15 January 2010 the Society repurchased £10.0m of subordinated debt at a discount. As a result, whilst remaining adequately capitalised, the Group has benefited from a one-off gain of £3.1m which will be accounted for in 2010.

36. Subscribed capital

	Group and Society	
	2009 £m	2008 £m
7.00% Permanent Interest Bearing Shares	60.0	60.0
Unamortised issue costs	(0.9)	(1.0)
Fair value adjustment for hedged risk	6.0	9.9
	65.1	**68.9**

The Permanent Interest Bearing Shares (PIBS) are unsecured and denominated in Sterling. They were issued on 1 June 2004. Net proceeds of the issue were £58.6m.

The PIBS are repayable, at the option of the Society, in whole on 1 June 2020 or any fifth anniversary thereafter. Repaying the PIBS requires the prior consent of the Financial Services Authority. If the PIBS are not repaid on a call date then the interest rate is reset at 1 June 2020 at 3% above the relevant equivalent gilt yield at the time.

PIBS are deferred shares of the Society and rank behind the claims of all depositors, creditors and investing Members of the Society.

The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

37. Analysis of general reserve

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Balance at 1 January	283.5	277.3	287.1	268.3
Profit for the financial year	10.8	5.7	9.3	18.3
Actuarial (loss)/gain on retirement benefit obligations	(8.9)	0.7	(8.9)	0.7
Movement in deferred tax relating to retirement benefit obligations	2.5	(0.2)	2.5	(0.2)
Total recognised income for the year	4.4	6.2	2.9	18.8
Balance at 31 December	**287.9**	**283.5**	**290.0**	**287.1**
Reserves excluding pension liability	297.8	284.8	299.9	288.4
Pension liability	(9.9)	(1.3)	(9.9)	(1.3)
	287.9	**283.5**	**290.0**	**287.1**

38. Other reserves

	Group and Society	
	2009 £m	2008 £m
Other reserves comprise:		
Revaluation reserve – available-for-sale investments	1.8	1.5
Movement in other reserves:		
Balance at 1 January	1.5	(0.5)
Net losses from changes in fair value, net of taxation	0.3	2.0
Balance at 31 December	**1.8**	**1.5**
Balance at 1 January	1.5	(0.5)
Loss transferred to equity	3.7	3.0
Gains recycled to profit and loss on sales	(3.3)	(0.3)
Taxation	(0.1)	(0.7)
Balance at 31 December	**1.8**	**1.5**

39. Financial commitments and contingent liabilities

a) Financial Services Compensation Scheme levy

Based on its share of protected deposits, the Society pays levies to the Financial Services Compensation Scheme (FSCS) to enable the FSCS to meet claims against it. In 2008 a number of institutions were declared in default by the FSA. The FSCS has met the claims by way of loans received from HM Treasury. The terms of these loans are interest only for the first three years and the FSCS will seek to recover the interest cost, together with ongoing management expenses, by way of annual levies on member firms over this period. The FSCS has, in turn, acquired the rights to the realisation of the assets of these financial institutions. The FSCS may have a further liability if there are insufficient funds available from the realisation of the assets of the financial institutions to fully repay the HM Treasury loans. To the extent that the loans have not been repaid in full by 31 March 2012, the FSCS will agree a schedule of repayments with HM Treasury. The FSCS will then levy the industry, including the Society, accordingly.

A provision of £5.2m was raised in the year ended 31 December 2008 in respect of these levies. A further provision of £1.4m has been recognised in the year and, in addition to the £5.2m already provided, represents the Society's best estimate of total levies payable. The Society has not been directly notified of the levies payable as a result of the claims against the FSCS and there are a number of factors that prevent accurate calculation of this future liability. As more information becomes available regarding compensation costs, it is possible that the Society will have to bear additional costs in future years. In addition, in April 2009 HM Treasury issued a Notification to the FSCS under the Banking Act 2009 requiring a contribution to the resolution costs of the failure of the Dunfermline Building Society. The timing and size of any actual payments by the FSCS under the Notification, and the consequent need for levies on the industry, is unclear.

Payments to the FSCS are made in three instalments with the first payment of £1.6m made in September 2009. Subsequent payments will be made in September 2010 and September 2011.

b) Payment protection insurance (PPI)

The FSA has recently published a Consultation Paper (CP09/23) on The Assessment and Redress of PPI Complaints. The proposals apply to all types of PPI policies, which, in the Group's case, relate to secured personal lending PPI products.

The consultation period closed on 30 October 2009. Due to the overwhelming response, the FSA is planning to set out its proposals in a Policy Statement early in 2010. Given the current stage of the consultation process, any impact on the Group of the need to offer wider redress cannot be reliably estimated.

c) Commitments under non-cancellable operating leases:

	2009		2008	
	Property	Vehicles, plant and equipment	Property	Vehicles, plant and equipment
	£m	£m	£m	£m
Group commitments in respect of operating lease rentals:				
Due within one year	1.8	0.2	1.6	0.3
Due between two and five years	6.9	0.3	5.9	0.1
Due after five years	10.2	-	9.9	-
	18.9	0.5	17.4	0.4
Society commitments in respect of operating lease rentals:				
Due within one year	0.8	0.2	0.6	0.3
Due between two and five years	3.3	0.2	2.4	0.1
Due after five years	4.4	-	3.7	-
	8.5	0.4	6.7	0.4

d) Capital commitments:

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Capital expenditure contracted for but not provided for	1.0	0.8	1.0	0.7

40. Financial instruments

a) Categories of financial instruments

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

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

Group and Society As at 31 December 2009	Financial assets and liabilities at amortised cost £m	Loans and receivables £m	Financial assets available for sale £m	Financial assets held to maturity £m	Financial assets and liabilities designated at fair value £m	Derivatives designated as fair value hedging instruments £m	Total £m
Society assets							
Cash in hand and balances with Bank of England	86.0	-	-	-	-	-	86.0
Loans and advances to credit institutions	-	208.5	-	-	-	-	208.5
Debt securities	-	-	1,084.5	-	-	-	1,084.5
Derivative financial instruments	-	-	-	-	12.9	23.4	36.3
Loans and advances to customers	-	4,069.9	-	-	-	-	4,069.9
Loans and advances to subsidiaries	-	668.8	-	-	-	-	668.8
Total financial assets	86.0	4,946.2	1,084.5	-	12.9	23.4	6,154.0
Total non-financial assets							58.9
Total Society assets							6,212.9
Additional Group assets							
Cash in hand and balances with Bank of England	50.3	-	-	-	-	-	50.3
Loans and advances to credit institutions	-	(49.0)	-	-	-	-	(49.0)
Loans and advances to customers	-	667.0	-	-	-	-	667.0
Elimination of loans and advances to subsidiaries	-	(668.8)	-	-	-	-	(668.8)
Non-financial assets							6.5
Group total assets							6,218.9
Society liabilities							
Shares	4,933.2	-	-	-	-	-	4,933.2
Amounts owed to credit institutions	446.4	-	-	-	-	-	446.4
Amounts owed to other customers	172.6	-	-	-	-	-	172.6
Debt securities in issue	93.0	-	-	-	-	-	93.0
Derivative financial instruments	-	-	-	-	0.6	50.0	50.6
Subordinated liabilities	125.6	-	-	-	-	-	125.6
Subscribed capital	65.1	-	-	-	-	-	65.1
Total financial liabilities	5,835.9	-	-	-	0.6	50.0	5,886.5
Total non-financial liabilities							34.2
General reserve and other reserves							292.2
Total Society reserves and liabilities							6,212.9
Additional Group liabilities							
Amounts owed to credit institutions	1.6	-	-	-	-	-	1.6
Amounts owed to other customers	-	-	-	-	-	-	-
Non-financial liabilities	-	-	-	-	-	-	6.5
General reserve and other reserves	-	-	-	-	-	-	(2.1)
Group total liabilities	-	-	-	-	-	-	6,218.9

40. Financial instruments (continued)

a) Categories of financial instruments (continued)

Group and Society As at 31 December 2008	Financial assets and liabilities at amortised cost	Loans and receivables	Financial assets available for sale	Financial assets held to maturity	Financial assets and liabilities designated at fair value	Derivatives designated as fair value hedging instruments	Total
	£m	£m	£m	£m	£m	£m	£m
Society assets							
Cash in hand and balances with Bank of England	6.1	-	-	-	-	-	6.1
Loans and advances to credit institutions	-	194.2	-	-	-	-	194.2
Debt securities	-	-	1,180.3	-	-	-	1,180.3
Derivative financial instruments	-	-	-	-	18.8	30.1	48.9
Loans and advances to customers	-	4,175.2	-	-	-	-	4,175.2
Loans and advances to subsidiaries	-	715.2	-	-	-	-	715.2
Total financial assets	**6.1**	**5,084.6**	**1,180.3**	**-**	**18.8**	**30.1**	**6,319.9**
Total non-financial assets							75.9
Total Society assets							**6,395.8**
Additional Group assets							
Cash in hand and balances with Bank of England	-	-	-	-	-	-	-
Loans and advances to credit institutions	-	1.4	-	-	-	-	1.4
Loans and advances to customers	-	709.1	-	-	-	-	709.1
Elimination of loans and advances to subsidiaries		(715.2)					(715.2)
Non-financial assets							7.6
Group total assets							**6,398.7**
Society liabilities							
Shares	4,626.4	-	-	-	-	-	4,626.4
Amounts owed to credit institutions	65.4	-	-	-	-	-	65.4
Amounts owed to other customers	733.9	-	-	-	-	-	733.9
Debt securities in issue	383.9	-	-	-	-	-	383.9
Derivative financial instruments	-	-	-	-	1.5	69.0	70.5
Subordinated liabilities	125.9	-	-	-	-	-	125.9
Subscribed capital	68.9	-	-	-	-	-	68.9
Total financial liabilities	**6,004.4**	**-**	**-**	**-**	**1.5**	**69.0**	**6,074.9**
Total non-financial liabilities							30.9
General reserve and other reserves							290.0
Total Society reserves and liabilities							**6,395.8**
Additional Group liabilities							
Amounts owed to credit institutions	2.9	-	-	-	-	-	2.9
Amounts owed to other customers	-	-	-	-	-	-	-
Non-financial liabilities	-	-	-	-	-	-	-
General reserve and other reserves	-	-	-	-	-	-	-
Group total liabilities							**6,398.7**

40. Financial instruments (continued)

b) Carrying values and fair values

The table below compares carrying values and fair values of the Group's financial instruments by category. It is accompanied by an explanation of the methods used to determine fair value.

	Note	Group 2009		Society 2009	
		Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets					
Cash in hand and balances with Bank of England		136.3	136.3	86.0	86.0
Loans and advances to credit institutions	i.	147.0	147.0	196.0	196.0
CSA deposits		12.5	12.5	12.5	12.5
Debt securities – available-for-sale	ii.	1,084.5	1,084.5	1,084.5	1,084.5
Derivative financial instruments					
Interest rate swaps	iii.	24.1	24.1	24.1	24.1
Cross currency interest rate swaps	iv.	12.2	12.2	12.2	12.2
Loans and advances to customers	v.	4,736.9	4,698.9	4,069.9	4,072.4
Loans and advances to subsidiaries		-	-	668.8	668.8
		6,153.5	**6,115.5**	**6,154.0**	**6,156.5**
Financial liabilities					
Shares	vi.	4,933.2	4,933.2	4,933.2	4,933.2
Amounts owed to credit institutions	vii.	448.0	448.0	446.4	446.4
Amounts owed to other customers	vii.	172.6	173.6	172.6	173.6
Debt securities in issue	vii.	93.0	92.4	93.0	92.4
Derivative financial instruments					
Interest rate swaps	iii.	50.6	50.6	50.6	50.6
Subordinated liabilities	viii.	125.6	57.3	125.6	57.3
Subscribed capital	viii.	65.1	32.4	65.1	32.4
		5,888.1	**5,787.5**	**5,886.5**	**5,785.9**

	Note	Group 2008		Society 2008	
		Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial assets					
Cash in hand and balances with Bank of England		6.1	6.1	6.1	6.1
Loans and advances to credit institutions	i.	203.6	203.6	202.2	202.2
CSA deposits		(8.0)	(8.0)	(8.0)	(8.0)
Debt securities – available-for-sale	ii.	1,180.3	1,180.3	1,180.3	1,180.3
Derivative financial instruments					
Interest rate swaps	iii.	32.7	32.7	32.7	32.7
Cross currency interest rate swaps	iv.	16.2	16.2	16.2	16.2
Loans and advances to customers	v.	4,884.3	4,841.0	4,175.2	4,177.1
Loans and advances to subsidiaries		-	-	715.2	715.2
		6,315.2	**6,271.9**	**6,319.9**	**6,321.8**
Financial liabilities					
Shares	vi.	4,626.4	4,626.4	4,626.4	4,626.4
Amounts owed to credit institutions	vii.	68.3	68.3	65.4	65.5
Amounts owed to other customers	vii.	733.9	739.7	733.9	739.7
Debt securities in issue	vii.	383.9	382.0	383.9	382.0
Derivative financial instruments					
Interest rate swaps	iii.	70.5	70.5	70.5	70.5
Subordinated liabilities	viii.	125.9	105.0	125.9	105.0
Subscribed capital	viii.	68.9	38.2	68.9	38.2
		6,077.8	**6,030.1**	**6,074.9**	**6,027.3**

The gross amount of foreign currency swaps held was €60.0m (2008: €60.0m).

40. Financial instruments (continued)

b) Carrying values and fair values (continued)

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The following methods and assumptions have been applied in determining fair value:

i) The carrying amount of loans and advances to credit institutions with a maturity of under 12 months is assumed to equate to their fair value.

ii) Debt securities classified as available-for-sale are measured at fair value by reference to market prices.

iii) All derivatives are held for economic hedging purposes. The fair value of interest rate swaps is calculated by utilising discounted cash flow valuation models. The fair value of cross currency interest rate swaps is obtained from external counterparties.

iv) The fair value of loans and advances to customers at a variable rate is assumed to approximate to their carrying amounts. The fair value of loans and advances to customers at a fixed rate of interest represents the discounted amount of estimated future cash flows expected to be received after taking account of expected levels of early repayment and discounting at current market rates.

v) The fair value of loans and advances to subsidiaries at a variable rate is assumed to approximate to their carrying amounts.

vi) The fair value of customer accounts is assumed to approximate to the amount payable at the date of the statement of financial position.

vii) The fair values of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue are established by using discounted cash flow valuation models or are assumed to approximate to the amount payable at the date of the statement of financial position.

viii) The fair value of subordinated liabilities and subscribed capital are obtained from market prices.

c) Credit risk

The classes of financial instruments which the Group is most exposed to credit risk are loans and advances to customers, loans and advances to credit institutions, debt securities and financial derivatives.

The following table shows the Group's estimated maximum exposure to credit risk without taking into account any collateral held or other credit enhancements.

For financial assets recognised in the statement of financial position, the exposure to credit risk equals their carrying amount. For loan commitments and guarantees the exposure to credit risk is the full amount committed.

	Group		Society	
	2009 £m	2008 £m	2009 £m	2008 £m
Financial assets				
Loans and advances to credit institutions	147.0	203.6	196.0	202.2
Debt securities	1,084.5	1,180.3	1,084.5	1,180.3
Loans and advances to customers	4,736.9	4,884.3	4,069.9	4,175.2
Loans and advances to subsidiaries	-	-	668.8	715.2
Derivative financial instruments				
Interest rate swaps	36.3	48.9	36.3	48.9
	6,004.7	6,317.1	6,055.5	6,321.8
In respect of loans and advances to credit institutions, debt securities and derivate instruments:				
UK government securities	592.3	251.7	592.3	251.7
UK financial institutions authorised by FSA	737.8	1,173.1	736.5	1,171.7
	1,330.1	1,424.8	1,328.8	1,423.4

40. Financial instruments (continued)

c) Credit risk (continued)

The percentage of these exposures that are rated between A and AAA under Fitch ratings for 2009 is 96.8% (2008: 96.7%).

Collateral is not held over loans and advances to credit institutions and debt securities. Net collateral of £12.5m (2008: £8.0m paid) is held over derivative financial instruments.

None of these exposures was either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

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.

	Group 2009		Society 2009	
	£m	%	£m	%
In respect of loans and advances to customers:				
Fully secured by a first charge on residential property	3,475.3	73.4	3,475.3	85.4
Fully secured by a first charge on land	594.6	12.6	594.6	14.6
Fully secured by a second charge on residential property	574.0	12.0	-	-
Partially secured by a second charge on residential property	93.0	2.0	-	-
	4,736.9	100.0	4,069.9	100.0
Retail financial services	3,112.5	65.7	3,112.6	76.5
Commercial loans	957.3	20.2	957.3	23.5
Secured personal loans	667.1	14.1	-	-
	4,736.9	100.0	4,069.9	100.0
Using the Group's standard credit risk grading system, residential lending can be distributed as follows:				
Fully secured by a first charge on residential property				
Grades 1 to 3 satisfactory	2,415.3	77.6	2,415.3	77.6
Grades 4 to 5 watch list	616.3	19.8	616.3	19.8
Grades 5 to 6 special mention but not impaired	80.9	2.6	80.9	2.6
	3,112.5	100.0	3,112.5	100.0
Fully secured by a second charge on residential property				
Personal loans - employed	565.4	84.8	-	-
Personal loans - self-employed	101.6	15.2	-	-
	667.0	100.0	-	-
Total loans secured on residential property	3,779.5		3,112.5	

40. Financial instruments (continued)

c) Credit risk (continued)

	Group 2008		Society 2008	
	£m	%	£m	%
In respect of loans and advances to customers:				
Fully secured by a first charge on residential property	3,586.7	73.4	3,586.7	85.9
Fully secured by a first charge on land	588.5	12.0	588.5	14.1
Fully secured by a second charge on residential property	622.3	12.8	-	-
Partially secured by a second charge on residential property	86.8	1.8	-	-
	4,884.3	100.0	4,175.2	100.0
Retail financial services	3,228.5	66.1	3,228.5	77.3
Commercial loans	946.7	19.4	946.7	22.7
Secured personal loans	709.1	14.5	-	-
	4,884.3	100.0	4,175.2	100.0
Using the Group's standard credit risk grading system, residential lending can be distributed as follows:				
Fully secured by a first charge on residential property				
Grades 1 to 3 satisfactory	2,644.2	81.9	2,644.2	81.9
Grades 4 to 5 watch list	513.3	15.9	513.3	15.9
Grades 5 to 6 special mention but not impaired	71.0	2.2	71.0	2.2
	3,228.5	100.0	3,228.5	100.0
Fully secured by a second charge on residential property				
Personal loans - employed	585.5	82.6	-	-
Personal loans - self-employed	123.6	17.4	-	-
	709.1	100.0	-	-
Total loans secured on residential property	3,937.6		3,228.5	

The average index-linked loan to value (LTV) in respect of the Group's loans secured on residential property is estimated to be 68.42% (2008: 57.5%). Index-linked LTV banding is shown below:

	Group		Society	
	2009 %	2008 %	2009 %	2008 %
Less than 70%	59.7	61.7	77.9	82.9
More than 70% but less than 80%	9.9	7.8	8.3	6.9
More than 80% but less than 90%	9.2	8.6	6.3	5.4
More than 90%	21.2	21.9	7.5	4.8
	100.0	100.0	100.0	100.0

The Group provides loans secured on residential property across England and Wales and the Society, as a regional building society, has a geographical concentration in Wales. As at 31 December 2009, approximately 41.2% of residential exposures by account and 41.3% by value were concentrated in Wales.
The percentage of retail lending cases fully secured by a first charge currently with arrears greater than 2.5% of the total outstanding balance is 1.02% (2008: 1.03%) which compares favourably with the industry average of 1.72% (CML arrears and possession data at 31 December 2009).
Total arrears balances on retail lending fully secured by a first charge were £1.8m and there are 198 residential cases six months or more in arrears.
The percentage of secured personal loans currently in arrears by number is 8.64% (2008: 6.30%), which by value is 10.13% (2008: 7.22%).

40. Financial instruments (continued)

c) Credit risk (continued)

The table below provides further information on the Group's loans secured on residential property by payment due status.

	Group 2009		Group 2008	
	£m	%	£m	%
Current	3,540.1	93.7	3,748.4	95.2
Past due up to 3 months	128.5	3.4	124.6	3.2
Past due 3 months up to 6 months	35.3	0.9	29.1	0.7
Past due 6 months up to 12 months	33.7	0.9	23.8	0.6
Past due over 12 months	36.6	1.0	6.3	0.2
Possessions	5.4	0.1	5.4	0.1
	3,779.6	100.0	3,937.6	100.0

	Society 2009		Society 2008	
	£m	%	£m	%
Current	2,988.2	96.0	3,113.6	96.4
Past due up to 3 months	86.5	2.8	82.6	2.6
Past due 3 months up to 6 months	19.7	0.6	18.2	0.6
Past due 6 months up to 12 months	11.3	0.4	8.1	0.2
Past due over 12 months	1.4	-	0.7	-
Possessions	5.4	0.2	5.3	0.2
	3,112.5	100.0	3,228.5	100.0

The Group holds collateral against loans and advances to residential customers in the form of mortgage interests over property. £6.1m (2008: £5.8m) of collateral is held against possession cases. Repossessed properties are made available-for-sale in accordance with statutory guidelines with proceeds used to reduce or repay the outstanding loan. The Group has a statutory duty to obtain the best reasonable price and to sell as soon as it reasonably can.

The Group has mortgage indemnity guarantee insurance which after a set first value of excess provides additional protection up to an agreed level.

	Group and Society			
	2009		2008	
	£m	%	£m	%
Commercial loans – Registered Social Landlords secured on residential property	121.8	12.7	97.2	10.3
Commercial loans – other	835.5	87.3	849.5	89.7
	957.3	100.0	946.7	100.0

Loans secured on commercial property are well diversified by industry type with the largest exposure to one counterparty amounting to £46.7m (2008: £48.4m) or 5% (2008: 5%) of gross balances. Asset quality remains strong with total arrears balances of £1.8m and only 6 commercial cases three months or more in arrears.

40. Financial instruments (continued)

c) Credit risk (continued)

The table below provides further information on commercial loans and advances by payment due status.

	Group and Society	
	2009 £m	2008 £m
Current	949.4	922.8
Past due up to 3 months	0.2	11.3
Past due 3 months and up to 6 months	-	2.1
Past due 6 months and up to 12 months	2.2	4.5
Past due over 12 months	5.5	6.0
	957.3	**946.7**

Loans and advances to subsidiaries are unsecured obligations and have no fixed repayment date. None of these exposures were either past due or impaired.

d) Liquidity risk

For each material class of non-derivative financial liability a maturity analysis is provided in Notes 28 to 31, which represents contractual maturities. In practice, customer deposits will be repaid later than on the contractual date on which repayment can be required.

The following is an analysis of gross contractual cash flows payable under financial liabilities:

	Total	Payable on demand	Up to 3 months	3-12 months	1-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m
Group						
As at 31 December 2009						
Non-derivative liabilities						
Shares	4,976.6	1.2	2,608.9	1,188.5	1,178.0	-
Amounts owed to credit institutions, other customers and debt securities in issue	703.3	1.6	345.1	307.7	35.3	13.6
Subordinated liabilities	132.9	-	3.2	3.2	126.5	-
Subscribed capital	104.1	-	-	4.2	16.8	83.1
	5,916.9	**2.8**	**2,957.2**	**1,503.6**	**1,356.6**	**96.7**
Society						
As at 31 December 2009						
Non-derivative liabilities						
Shares	4,976.6	1.2	2,608.9	1,188.5	1,178.0	-
Amounts owed to credit institutions, other customers and debt securities in issue	701.7	-	345.1	307.7	35.3	13.6
Subordinated liabilities	132.9	-	3.2	3.2	126.5	-
Subscribed capital	104.1	-	-	4.2	16.8	83.1
	5,915.3	**1.2**	**2,957.2**	**1,503.6**	**1,356.6**	**96.7**
Group and Society						
As at 31 December 2009						
Derivative liabilities						
Interest rate swaps - outflows	(174.5)	-	(16.7)	(41.1)	(82.7)	(34.0)
Interest rate swaps - inflows	107.8	-	6.7	36.2	45.8	19.1
Cross currency interest rate swaps - outflows	(54.9)	-	(0.2)	(0.4)	(36.5)	(17.8)
Cross currency interest rate swaps - inflows	54.9	-	0.2	0.4	36.5	17.8
	(66.7)	**-**	**(10.0)**	**(4.9)**	**(36.9)**	**(14.9)**

The balances in the above table will not agree directly to the balances in the consolidated statement of financial position as the table incorporates all cash flows on an undiscounted basis related to both principal as well as future interest payments based on rates prevailing at the date of the statement of financial position.

For information on annual commitments under non-cancellable operating leases see Note 39 of the financial statements.

40. Financial instruments (continued)

d) Liquidity risk (continued)

	Total	Payable on demand	Up to 3 months	3-12 months	1-5 years	More than 5 years
	£m	£m	£m	£m	£m	£m
Group						
As at 31 December 2008						
Non-derivative liabilities						
Shares	4,652.7	1,915.1	1,470.4	942.6	324.6	-
Amounts owed to credit institutions, other customers and debt securities in issue	1,232.2	14.8	680.7	494.2	100.0	14.5
Subordinated liabilities	139.3	-	3.2	3.2	132.9	-
Subscribed capital	108.3	-	-	4.2	16.8	87.3
	6,132.5	**1,929.9**	**2,082.3**	**1,444.2**	**574.3**	**101.8**
Society						
As at 31 December 2008						
Non-derivative liabilities						
Shares	4,652.7	1,915.1	1,470.4	942.6	324.6	-
Amounts owed to credit institutions, other customers and debt securities in issue	1,229.4	11.9	608.7	494.3	100.0	14.5
Subordinated liabilities	139.3	-	3.2	3.2	132.9	-
Subscribed capital	108.3	-	-	4.2	16.8	87.3
	6,129.7	**1,927.0**	**2,082.3**	**1,444.3**	**574.3**	**101.8**
Group and Society						
As at 31 December 2008						
Derivative liabilities						
Interest rate swaps - outflows	100.7	-	15.3	23.9	38.5	23.0
Interest rate swaps - inflows	(112.1)	-	(17.9)	(38.7)	(37.3)	(18.2)
Cross currency interest rate swaps - outflows	68.1	-	0.6	1.9	45.1	20.5
Cross currency interest rate swaps - inflows	(68.1)	-	(0.6)	(1.9)	(45.1)	(20.5)
	(11.4)	**-**	**(2.6)**	**(14.8)**	**1.2**	**4.8**

e) Market risk

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

Interest rate risk

Interest rate risk refers to the sensitivity of net interest income to the periodic re-pricing of assets and liabilities and the imperfect correlation caused by basis risk. The Group's exposure to interest rate risk in terms of the net risk after taking account of management's action to hedge inherent exposures is measured using interest rate gap analysis. In this method each of the Group's financial instruments including on and off the statement of financial position assets and liabilities is assigned to future time periods on the basis of their contractual maturity or contractual re-pricing arrangements. In calculating the net exposure for each future period, account is also taken of those assets and liabilities with embedded optionality, such as pipeline and prepayment risk on fixed rate mortgages. If there was a 1% parallel upward shift in interest rates the adverse impact on reserves would be £4.2m (2008: £5.0m), and on profit and loss would be £5.3m (2008: £1.1m).

Currency risk

After taking into account the effect of cross currency swaps the Group has no material exposure to foreign exchange rate fluctuations or changes in foreign currency interest rates.

Notes to the accounts

41. Related party transactions

Loans to and shares held by directors

There was an aggregate of £0.8m (2008: £0.8m) outstanding at the end of the financial year in respect of secured advances made prior to or during the year to directors.

In so far as it is required under Section 68(I) and Section 68(3) of the Building Societies Act 1986, details of such loans are maintained in a register kept at Principality Buildings, Queen Street, Cardiff and a statement containing requisite particulars will be available for inspection by Members at the same address for the period of fifteen days prior to the Annual General Meeting to be held on 23 April 2010.

As required by the Society's Rules, each director has a share account. The Society's duty of confidentiality to its Members precludes individual disclosure of these details; the aggregate total of deposits held by directors was £0.6m (2008: £0.2m).

Transactions with Group companies

The Society undertook the following transactions with Group companies during the year:

	Interest received from Society	Interest paid to Society	Fees received from Society	Fees paid to the Society	Rent received from Society	Rent paid to Society
	£m	£m	£m	£m	£m	£m
Year ended 31 December 2009						
Nemo Personal Finance Limited	-	16.2	-	0.1	-	-
Peter Alan Limited	-	-	-	0.1	-	0.2
	-	16.2	-	0.2	-	-
Year ended 31 December 2008						
Nemo Personal Finance Limited	-	42.7	-	0.1	-	-
Peter Alan Limited	-	-	-	-	-	0.2
	-	42.7	-	0.1	-	0.2

At the year end the following balances were outstanding:

	Loans owed to Society	Loans owed by Society	Loans owed to Society	Loans owed by Society
	2009 £m	2009 £m	2008 £m	2008 £m
Nemo Personal Finance Limited	665.3	-	713.2	-
Peter Alan Limited	2.4	-	2.0	-
Principality Independant Financial Advisers Limited	-	-	-	0.2
Principality Mortgage Corporation Limited	-	-	-	0.1
	667.7	-	715.2	0.3

42. Events after the statement of financial position

On 15 January 2010 the Society repurchased £10.0m of subordinated debt at a discount. As a result, whilst remaining adequately capitalised, the Group has benefited from a one-off gain of £3.1m which will be accounted for in 2010.

Annual Business Statement

for the year ended 31 December 2009

1. Statutory percentages

	At 31 December 2009 %	At 31 December 2008 %	Statutory limit %
The lending limit	15.0	14.7	25.0
The funding limit	12.8	20.6	50.0

The percentages are calculated in accordance with, and the statutory limits are those prescribed by, Sections 6 and 7 of the Building Societies Act 1986 (as substituted by the Building Societies Act 1997) and are based on the consolidated statement of financial position.

The lending limit is the proportion of business assets not in the form of loans fully secured on residential property.

The funding limit is the proportion of shares and borrowings not in the form of customer accounts held by individuals.

Business assets are the total assets of the Society and its subsidiary undertakings as shown in the statement of financial position plus provision for loan impairment, less fixed assets and liquid assets.

Loans fully secured on residential property are the amount of principal owed by borrowers and interest accrued not yet payable. This is the amount shown in the statement of financial position plus provision for loan impairment and minus unamortised loan origination fees.

2. Other percentages

Calculated from consolidated accounts:

	2009 %	2008 %
As a percentage of shares and borrowings:		
Gross capital	8.52	8.00
Free capital	8.71	7.94
Liquid assets	24.49	23.98
As a percentage of mean total assets:		
Profit after taxation (excluding Financial Services Compensation Scheme levy)	0.19	0.15
Management expenses	0.95	1.04

Gross capital represents retained earnings, subscribed capital and subordinated liabilities as shown in the consolidated statement of financial position.

Free capital is gross capital plus provision for impairment losses less intangible assets and property, plant and equipment.

Liquid assets represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities.

Mean total assets represent the average of the total assets in the consolidated statement of financial position at the beginning and end of the year.

Management expenses represent the aggregate of administrative expenses, depreciation and amortisation.

3. Directors

Details of directors are contained on pages 12 and 13.
Details of directors' service contracts are included in the Report of the Remuneration Committee on pages 22 to 25.
Documents may be served on any of the directors c/o Eversheds LLP, Reference PDV, 1 Callaghan Square, Cardiff CF10 5BT.

Managers

David Cunningham-Jones
Peter Hughes
Susan Lane
Michael Jones
Elaine Morris

No director or other officer, including connected persons, has any right to subscribe for shares in, or debentures of, any connected undertaking of the Society.

Subsidiary companies

Peter Alan Limited
Managing Director: Michael McGuire

Nemo Personal Finance Limited
Managing Directors: Phillip E. Jones
Samuel F. Marshall

Branch addresses

Principality Building Society
Customer Support Centre, PO Box 89, Principality Buildings, Queen Street, Cardiff CF10 1UA
Telephone 029 2077 3000 www.principality.co.uk

ABERDARE	10 Victoria Square CF44 7LA	01685 872400
ABERGAVENNY	68 Frogmore Street NP7 5AU	01873 856256
ABERYSTWYTH	15 Terrace Road SY23 1NY	01970 612728
BANGOR	220 High Street LL57 1NY	01248 364127
BARRY	1a Tynewydd Road CF62 8HB	01446 733506
BLACKWOOD	129 High Street NP12 1AB	01495 224687
BRIDGEND	28 Caroline Street CF31 1DQ	01656 655120
CAERPHILLY	The Twyn CF83 1JL	029 2086 9364
CARDIFF	Principality Buildings, Queen Street CF10 1UA	0845 045 0007
CARDIFF	39 Town Wall, St David's Centre, CF10 2EW	029 2022 7788
CARDIFF	105/107 Albany Road CF24 3LP	029 2048 7030
CARDIFF	95 Caerphilly Road, Birchgrove CF14 4AE	029 2061 5928
CARDIFF	174 Cowbridge Road East, Canton CF11 9NE	029 2037 3153
CARDIFF	36/38 High Street, Llandaff CF5 2DZ	029 2056 3094
CARDIFF	21 Merthyr Road, Whitchurch CF14 1DA	029 2062 4537
CARDIFF	796 Newport Road, Rumney CF3 4FH	029 2079 4721
CARDIFF	18 Station Road, Llanishen CF14 5LT	029 2076 4151
CARMARTHEN	13 Guildhall Square SA31 1PR	01267 235403
CHESTER	14 Bridge Street CH1 1NQ	01244 323039
COWBRIDGE	28 High Street CF71 7AG	01446 773954
DENBIGH	11 Vale Street LL16 3AD	01745 814549
EBBW VALE	2A The Walk NP23 6AY	01495 305569
FISHGUARD	29 West Street SA65 9AL	01348 873473
GORSEINON	86 High Street SA4 4BL	01792 896389
HAVERFORDWEST	5 Victoria Place SA61 2JX	01437 762147
HEREFORD	2 St. Peter's Square HR1 2PG	01432 273039
LAMPETER	45 High Street SA48 7BB	01570 422844
LLANDEILO	40 Rhosmaen Street SA19 6HD	01558 822638
LLANDRINDOD WELLS	Carlton House, Middleton Street LD1 5ET	01597 823511
LLANDUDNO	85 Mostyn Street, Llandudno LL30 2PD	01492 876326
LLANELLI	Unit 13, St Elli Square SA15 1SH	01554 746950
LLANTWIT MAJOR	1 The Precinct CF61 1XA	01446 794238
MAESTEG	139 Commercial Street CF34 9DW	01656 737111
MERTHYR TYDFIL	Beacons Place, CF47 8ED	01685 385421
MOLD	39 High Street CH7 1BQ	01352 756345
NEATH	1-3 Green Street SA11 1DR	01639 635316
NEWPORT	33 High Street NP20 1RU	01633 258206
PENARTH	1 Stanwell Road CF64 2AB	029 2070 2094
PONTYPOOL	3 Commercial Street NP4 6JJ	01495 758577
PONTYPRIDD	93-94 Taff Street CF37 4SL	01443 404027
PORTHCAWL	23 John Street CF36 3AP	01656 788257
PORT TALBOT	7 Riverside Walk SA13 1NY	01639 884055
PRESTATYN	99 High Street LL19 9AP	01745 852531
PWLLHELI	55a High Street LL53 5RT	01758 613331
SHREWSBURY	2 The Square SY1 1LA	01743 353430
SWANSEA	64-65 The Kingsway SA1 5HW	01792 655791
SWANSEA	53 Newton Road, Mumbles SA3 4BD	01792 360223
SWANSEA	101 Woodfield Street, Morriston SA6 8AS	01792 795589
TONYPANDY	30 Dunraven Street CF40 1AL	01443 422893
TREORCHY	220 High Street CF42 6AS	01443 772190
WREXHAM	20-22 Regent Street LL11 1SA	01978 261788

Agency offices

AMMANFORD	6 High Street, Dyfed SA18 2LY	01269 591884
BALA	87 High Street, Gwynedd LL23 7AG	01678 520495
CARDIGAN	3 Heathfield, Pendre SA43 1JT	01239 615050
MACHYNLLETH	Maldwyn House, Penrallt Street SY20 8AG	01654 703110
PORTHMADOG	103 High Street, Gwynedd LL49 9EY	01766 512011

Notes