

Half Year Financial
Statements

2012



**PRINCIPALITY
BUILDING SOCIETY**

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FORWARD-LOOKING STATEMENTS

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

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

Responsibility statement

We confirm that to the best of our knowledge:

(a) the condensed set of financial statements has been prepared in accordance with IAS 34 'Interim Financial Reporting';

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

(c) the interim management report includes a fair review of the information required by DTR 4.2.8 (disclosure of related party transactions and changes therein).

The information for the period ended 30 June 2012 does not constitute statutory accounts as defined in the Building Societies Act 1986. The auditor's report on the 2011 Annual Report and Accounts was not qualified and did not include a reference to any matters to which the auditor drew attention by way of emphasis without qualifying the report.

By order of the Board,

P L Griffiths
Chief Executive

W G Thomas
Group Finance Director

Foreword from the Chairman

Following Peter's resignation in late May, the Board has undertaken a rigorous selection process, working closely with a specialist executive search firm to select a suitable successor. Following the conclusion of this process, I am very pleased to announce that Graeme Yorston, currently the Society's Chief Operating Officer will officially take the reins as Chief Executive from 1 October 2012.

The Society has successfully weathered the economic climate and has emerged in excellent shape for the next stage of strategic development under Graeme's stewardship. Principality needs a Chief Executive with an in-depth knowledge of the UK Market, the consumer and our members. A strong understanding of the Society's diversified operating model and a deep commitment to the philosophy of mutuality are also qualities the Board required. Graeme undoubtedly possesses all of these attributes, together with a sound commercial mind. I am confident he will make an outstanding Chief Executive.

On behalf of the Board, our staff and Members of the Society, I would like to thank Peter for his outstanding contribution to the Society over the last 10 years.

Chief Executive's review

I am pleased to report that the Society continues to succeed in a tough market. As the wider banking sector continues to be tested by a whole host of issues, we are seeing a resurgence in support for the mutual model and the Society continues to benefit from a shift in social sentiment. Ever conscious of the potential future economic risks, we have managed the business prudently delivering controlled levels of growth, strong levels of profitability relative to the current economic climate and a continued strengthening of our balance sheet.

In addition, we continue to make investments for the future and are in the fortunate position of being able to do so. The low interest rate environment enhances our overall earnings capability, particularly in the subsidiary businesses, but we recognise it is testing for our savers. With interest rates predicted to remain lower for longer, we remain confident about the future and the Society's ability to deal with economic, regulatory and commercial challenges.

Trading Highlights

- Half year pre-tax profits of £14.0m (30 June 2011: £14.8m)
- Impairment provisions reduced by £4.1m to £8.2m (30 June 2011: £12.3m)
- General reserves increased by £9.0m (30 June 2011: £10.4m)
- A robust net interest margin of 1.47% (30 June 2011: 1.75%)
- Overall balance sheet impairment provisions of £65.1m (30 June 2011: £59.6m)
- A cost/income ratio of 56.6% (30 June 2011: 50.8%)
- Savings growth of £167.8m (30 June 2011: £101.9m)
- Over 28,000 new customers

All of our businesses have performed profitably during the first half and we do not expect any substantive change in our business model in the near term.

As we look ahead we do so against a background of increasing uncertainty in the economy, but also increasing confidence in our ability to deliver the range of products and services our members would expect. Funding costs have risen during the period but have been offset in the main by better than expected profits in the Nemo business. We continue to try to strike the delicate balance between acceptable profits and fair returns to our saving and borrowing members. Credit conditions remain tight and the regulatory agenda continues to throw up more uncertainty. We are keen to support both the social justice and economic recovery agendas and we continue to work closely with Welsh Government to support the Welsh housing agenda.

In the light of testing economic conditions, we have continued to de-risk the balance sheet, and impairment provisions for losses in our businesses remain at lower than budgeted levels and provide a level of reassurance and confidence for the future. We remain ever cautious of potential future affordability issues and the threat that rising interest rates ultimately will bring. The balance sheet is carrying strong levels of provision for potential losses with PPI remediation largely complete.

Capital and liquidity levels remain strong and with a robust balance sheet we will seek to increase lending levels in the near term. We are seeing strong savings flows and firmly believe our brand values resonate well with current and potential future Members. It has been a positive first half with the business remaining buoyant. Near term indicators give us every reason to predict a confident future.

I have worked alongside Graeme for the past six years. He is well known to the Board, staff and Members and I am delighted to be leaving the Society in his safe and capable hands. I extend my thanks, once again, to all those who have supported me over the last decade including past and current Chairmen, my Board, a loyal and dedicated team and a supportive set of Members. I look forward to the next chapter in my personal career, wherever that may take me, safe in the knowledge that Principality will continue to prosper in the years ahead.

P L Griffiths
Chief Executive
31 July 2012

Business review

for the six months ended 30 June 2012

Income statement

The Group's profit before tax for the six months ended 30 June 2012 was £14.0m (30 June 2011: £14.8m). Underlying profit was £17.9m (30 June 2011: £19.7m) which excludes provisions for liabilities and charges and other gains. Improvements in provisions for impairment losses and other income have been offset by higher funding costs. Changes to a key assumption relating to the Financial Services Compensation Scheme (FSCS) levy calculation have increased provisions by £1.1m.

Profit

Net interest margin

At 1.47% (30 June 2011: 1.75%) the Group's net interest margin benefits from higher margins earned in the secured personal lending division. Net interest margin has been enhanced by gains of £0.8m (30 June 2011: £0.8m), equivalent to 1bps (30 June 2011: 2bps) arising from the profit on the sale of gilts. The interest margin was supported by robust new mortgage margins which are expected to continue throughout the year. This has been offset by lower interest income in the secured personal lending division as a result of the sale of a number of loan portfolios to a third party during 2011.

The savings marketplace remains highly competitive and along with the requirement to hold lower yielding UK sovereign securities, has resulted in a reduction in the Group's interest margin which is expected to continue in the near term. Short-term wholesale funding is largely inaccessible and the medium-term outlook remains uncertain, reflecting continued turmoil in the European financial markets. The Group's current funding strategy means that this risk is largely mitigated in the short-term but ongoing uncertainties in the Eurozone may affect medium-term growth aspirations.

The Board have developed and implemented strategic plans to ensure the Group maintains a strong but balanced net interest margin that provides value and security to Members in the months and years ahead.

Other income

The Group's non-interest income at £13.1m (30 June 2011: £10.3m) includes insurance income, estate agency income, property services income and income generated from a number of other complementary activities. These together generated 21.9% (30 June 2011: 15.8%) of total income. Sales of life, investment and general insurance products remained flat during the first half of the year. An active lettings market over the first half of the year has resulted in a strong performance in Peter Alan with overall income 21.2% ahead of the same period last year.

During the first half of the year, the secured personal lending subsidiary sold a further loan portfolio totalling £26.9m which realised a profit on disposal of £1.0m. This is reflected in the fees and commission receivable line in the income statement.

Business review

for the six months ended 30 June 2012 (continued)

Administrative expenses

Ongoing strategic investments to enhance the Society's 'e' and technology capabilities, including improvements to the new website created during 2011, have resulted in an increase in the ratio of operating expense as a percentage of total mean assets to 1.05% (30 June 2011: 1.01%). The cost to income ratio was 56.6% (30 June 2011: 50.8%). This increase is as a result of the deliberate investment strategy to enhance capability, increase diversity in our income streams and provide long-term value.

During the second half of the year, the Society will open a new branch in Cwmbran along with a new Peter Alan branch in Cathays, Cardiff. This represents continued investment in the branch network and the importance placed on this distribution channel by the Board.

The cost of regulation is increasing and the move to harmonised regulatory reporting under the European Banking Authority's guidelines on *Common Reporting* (COREP) and *Financial Reporting* (FINREP), along with the implementation of other regulatory changes, including IFRS 9 *Financial Instruments*, IRB and BASEL III, will increase the cost base further as the Group invests to deliver enhanced reporting capabilities.

The Board has implemented a continuous improvement programme to drive cost efficiencies.

Impairment provisions for losses on loans and advances

The charge for impairment provisions of £8.2m for the Group is £4.1m lower than that for the same period last year (30 June 2011: £12.3m). Positive movements in the House Price Index (HPI) and forced-sale discount assumptions along with prudent arrears management policies that have contained arrears growth. Provisions in first charge residential lending increasing slightly with second charge residential lending provisions decreasing by £6.4m.

Total impairment provisions in the commercial lending division were £4.2m (30 June 2011: £2.5m). Of this, £2.0m relates to specific provisions where key assumptions have been updated. The commercial lending market remains challenging and a collective provision of £2.2m has been charged in the period reflecting the difficult environment. Accumulated impairment on mortgages secured on commercial property currently stands at 2.49% (30 June 2011: 1.79%) with only 11 exposures greater than three months in arrears (30 June 2011: 11). There are no arrears in respect of lending to Registered Social Landlords.

Provisions for other liabilities and charges

Provisions of £3.9m (30 June 2011: £4.9m) have been made in respect of various customer claims, including claims in relation to previous sales of payment protection insurance. Any liability is expected to crystallise over the next 6-12 months.

The FSCS levy provision has been adjusted to reflect the most up-to-date information with regards to the 2011/12 and 2012/13 levy years which have resulted in an increase in the provision of £1.1m.

It is expected that an additional provision in the region of £4.2m will be made at the year end in relation to the FSCS levy. This includes £1.5m in relation to capital shortfalls associated with the scheme. More information regarding the uncertainties associated with the level of the provision can be found in note 15a.

Taxation

The statutory rate of corporation tax was reduced to 24.0% from 1 April 2012. The Group is subject to corporation tax at a rate of 26.0% for the period 1 January to 31 March 2012, and 24.0% for the period 1 April to 31 December 2012, resulting in an effective statutory rate of corporation tax of 24.5% for the full year in 2012.

The actual effective tax rate for the Group was 25.7% (30 June 2011: 26.4%) compared with the statutory rate of tax of 24.5% (30 June 2011: 26.5%). The rate differential is mainly due to disallowable expenditure.

Business review

for the six months ended 30 June 2012 (continued)

Statement of Financial Position

Loans and advances to customers

The Group continues to focus on the quality of business written, concentrating on affordability and LTV ratios in underwriting loans and mortgages. Whilst lending criteria remain tight, there has been a strong performance during the first half of 2012 in residential first charge mortgages where advances have increased by 43.4% compared to the same period last year with total mortgage assets increasing by 4.3% since the end of the year to £5,444.3m. The Board continues to apply controls prudently to the Group's lending, reflecting the continued uncertainty in the wider economy.

The average LTV of the residential first and second charge portfolios stands at 63.7% (31 December 2011: 62.6%) with 73.7% of the portfolio under 80% LTV and only 7.9% in negative equity based on indexed property values.

We continue to support our Members and customers who are experiencing financial difficulties and agree the most appropriate course of action. Short-term temporary actions could include revised payment schedules, payment holidays or a switch to 'interest only' lending. Where revised payment schedules are insufficient to meet normal contractual monthly instalments or where a customer fails to meet the revised payment terms, the case will continue to accrue arrears and impairment provisions will be made where appropriate. Our approach to dealing with Members and customers in financial difficulties means that we only take possession of a property as a last resort. During the first half of the year 33 properties were taken into possession (30 June 2011: 33).

The risk reduction strategy implemented for the second charge and commercial lending portfolios is reflected in the declining and flat respective mortgage balances for these divisions. The average loan size in the commercial business has reduced by 0.7% from the year end.

Liquidity

Liquid assets typically comprise cash deposits held with central banks and unencumbered securities that may be sold or pledged through a repurchase agreement (repo) either directly with the central banks to which the Group has access or with other market counterparties.

The liquid asset buffer, as defined by the FSA, includes highly liquid assets which typically comprise cash held with central banks and gilts. Mortgage lending has increased during the first half of the year resulting in decreasing liquidity. The proportion of liquid assets assigned to the buffer is 75.8% (31 December 2011: 88.1%) however this still represents a surplus of 42.9% of our buffer liquidity requirement.

Of those assets not assigned to the Liquid Asset Buffer, 5.19% of investments with other financial institutions are less than A rated under Fitch credit ratings (31 December 2011: 2.40%). The Group continues to monitor the short-term liquidity stress metric, the Liquidity Coverage Ratio (LCR), and a long-term, liquidity metric, the Net Stable Funding Ratio (NSFR).

The £10.0m (31 December 2011: £10.0m) exposure to Anglo Irish Bank Corporation Limited was repaid in full in June 2012. The Group has no direct exposures to Greece, Italy, Portugal, Cyprus, Ireland or Spain. Based on available information, an assessment has been made of the Society's key counterparties regarding the potential levels of indirect exposure to distressed Eurozone economies. After such an assessment, the Board has concluded that no impairment provisions are required for indirect exposures to Eurozone sovereign debt.

During the period the Group continued to perform internal stress tests on its liquidity which consistently demonstrates a strong position after allowing for a range of extreme stress scenarios and mitigating actions. The results of these scenarios are brought together into the Group's Individual Liquidity Adequacy Assessment (ILAA) document which is reviewed at least annually by the Board.

Business review

for the six months ended 30 June 2012 (continued)

Funding

The Society has a strong funding base, predominantly represented by retail savings. As a result, less reliance is placed on wholesale markets. Savings balances represent 95.2% (31 December 2011: 96.1%) of all mortgage balances. The savings environment remains highly competitive and the Board's focus has been to secure and retain funds at economic rates whilst providing value to Members.

In August 2011, the Society issued an £814.0m AAA rated residential mortgage backed security resulting in additional funding of £300.0m along with a further £200.0m facility. The Group holds £443.0m of the notes, £315.0m of which are capable of repo financing either directly with the market or with central banks to which the Group has direct access, and therefore represent contingent liquidity available to the Group if necessary. These assets are not recognised in the statement of financial position as the Group retains the risks and rewards of the mortgages.

Borrowings from wholesale sources, administered by the Group's treasury function, have reduced by £43.8m since the year end. At 12.94% (31 December 2011: 13.96%) of all shares, deposits and loans, the Group's borrowings represent a low dependence on wholesale markets. Principality's strong retail brand and reputation has allowed choice over funding sources during a period when wholesale markets remain largely inaccessible. Balancing the mix of funding through wholesale markets and retail remains a key focus and the Board is committed to maintaining a prudent position.

The Society's long-term debt ratings with Fitch and Moody's, at BBB+ and Ba1 respectively, remain unchanged since the end of the year.

Capital

Capital comprises the Group's general reserve, permanent interest-bearing shares (subscribed capital) and subordinated liabilities. This capital is held to support the development of the business, to protect Members' deposits and provide a buffer against unexpected losses. Total capital has increased from £509.1m at the end of 2011 to £520.3m. The Core Tier 1 and Tier 1 ratios (including interim profits) have increased to 11.66% and 13.64% respectively compared to 11.48% and 13.49% as at 31 December 2011. The Core Tier 1 and Tier 1 ratios are well in excess of the minimum Basel III requirements as currently drafted.

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 statement of financial position date, has decreased by 0.26% to 16.63% since the year end. This decrease is due to the impact of reducing eligibility of subordinated liabilities within the solvency calculation. The solvency ratio however, is well in excess of the minimum established by the FSA.

The Group currently adopts the standardised approach for the calculation of regulatory capital requirements and is in the process of applying to the FSA for permission to adopt the Internal Ratings Based (IRB) approach. This would allow the Group to use its own estimates of risk, rather than risk weightings prescribed by the FSA, after certain conditions have been satisfied, and will further enhance the Group's risk management processes.

A glossary of terms can be found on pages 95 to 98 of the 2011 Annual Report and Accounts.

Business review

for the six months ended 30 June 2012 (continued)

Going concern

The Group meets its funding requirements, which include the need to maintain a sufficient liquidity buffer, mainly from retail sources supplemented by an RMBS issue during 2011. 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) and Individual Liquidity Adequacy Assessment (ILAA), which are processes required by the FSA to demonstrate appropriate levels of capital and liquidity respectively under stressed scenarios reflecting the directors' views of different risks that might arise under varying economic conditions. These scenarios take account of reasonably possible changes in trading performance, and show that the Group will be able to operate within the sources of funding currently available to it, even under stressed scenarios. In addition to these sources, contingency funding plans are in place.

The assets held for liquidity purposes are assessed and regularly 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 £390.3m (13.64% as a percent of risk-weighted assets) and a solvency ratio of 16.63% is adequate.

The directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 18 months from the date of this report. Therefore, the accounts are prepared on a going concern basis.

Principal risks and uncertainties

The Group Risk Committee, which meets at least quarterly, is responsible for reviewing strategic, operational and financial risks and ensuring that appropriate action is taken to mitigate those risks. Further information on the outlook for the second half of the year is detailed in the Chief Executive's report on page 1. Additional information on risk is also provided in the Pillar 3 disclosure available at:

<http://www.principality.co.uk/en/About-Us/About-Principality/Financial-Reports.aspx>

The principal risks and uncertainties which have an impact on the Group's long-term performance remain those outlined on pages 15 to 19 of the 2011 Annual Report and Accounts. These risks include:

Credit risk

This is the risk that a customer or counterparty will fail to meet their financial obligations to the Group as they become due. The volatility and continued fragility of the national and international economy presents, amongst other things, a risk of increased unemployment and declining house prices which would impact arrears and loan loss provision levels.

The Group remains cautious with regard to commercial lending which is undertaken on a prudent basis, where management has adopted a strategy geared towards reducing overall exposure to development finance and larger, single counterparty loans. Commercial lending is operated within a framework of conservative credit criteria, principally focusing on the underlying income stream and debt servicing cover as well as property value.

The impact of the continued Eurozone crisis increases the risk of credit default in wholesale markets. A weekly review of counterparty exposures is undertaken by the Treasury Committee in order to identify and mitigate the potential likelihood of any future performance difficulties or losses based on emerging published data and market intelligence.

Business review

for the six months ended 30 June 2012 (continued)

Liquidity risk

This 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 directors have considered the funding and liquidity risk under the heading 'Going concern' above.

Market risk

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, including the use of derivatives, and foreign currency risk.

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

The Eurozone crisis along with the UK Government and Bank of England's response to mortgage lending and other economic and banking sector issues continue to create short-term volatility in market prices. Taking account of this, the Asset and Liability Committee has continued to manage the Group's market risk exposure prudently.

There remains some uncertainty in respect of the future operation of the levies payable to the FSCS in relation to the restructuring of a number of failed institutions and how scheme capital shortfalls are to be allocated across the industry. More information regarding the uncertainties associated with the future funding of the scheme can be found in note 39 to the 2011 Annual Report and Accounts.

Operational risk

With an increasingly diverse business model and a more competitive operating environment, it is recognised that the Group is exposed to increased levels of operational risk, for example in terms of systems capability and staff competencies. The financial services sector also faces growing levels of financial crime, particularly in relation to e-distribution channels, which require increasingly sophisticated monitoring and anti-fraud controls. The Group has adopted The Standardised Approach for the calculation of regulatory capital requirements relating to operational risk. This is supported by a governance structure and risk management framework the purpose of which is to identify, assess and manage existing and emerging operational risks arising from current and planned business activities, and mitigate as far as possible the impact of unknown events.

Pension obligation risk

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

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

Details of the pension obligations of the Group can be found on page 11 and on page 19 of the 2011 Annual Report and Accounts.

W G Thomas
Group Finance Director
31 July 2012

Independent review report

to Principality Building Society

We have been engaged by the Society to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2012 which comprises the condensed consolidated statement of comprehensive income, the condensed consolidated statement of recognised income and expense, the condensed consolidated statement of financial position, the condensed consolidated statement of cash flows and related notes 1 to 17. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

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

Directors' responsibilities

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

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

Our responsibility

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

Scope of Review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2012 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Services Authority.

Deloitte LLP

Chartered Accountants and Statutory Auditor
Cardiff, United Kingdom
31 July 2012

Condensed consolidated statement of comprehensive income

Group Interim results for six months to 30 June 2012

	Notes	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
Interest receivable and similar income	3	123.8	115.0	235.4
Interest payable and similar charges	4	(76.1)	(60.5)	(130.4)
Net interest income		47.7	54.5	105.0
Fees and commission receivable	5	13.3	10.2	20.6
Fees and commission payable	6	(0.6)	(0.8)	(1.4)
Net fee and commission income		12.7	9.4	19.2
Other operating income		0.4	0.9	1.4
Other fair value gains and losses	7	(0.7)	0.3	(0.1)
Net operating income		60.1	65.1	125.5
Administrative expenses	8	(30.9)	(30.0)	(60.0)
Depreciation and amortisation		(3.1)	(3.1)	(6.2)
Total operating expenses		(34.0)	(33.1)	(66.2)
Impairment provision for losses on loans and advances		(8.2)	(12.3)	(24.6)
Provision for liabilities and charges	12	(3.9)	(4.9)	(11.2)
Operating profit		14.0	14.8	23.5
Other gains	9	-	-	1.0
Profit before tax		14.0	14.8	24.5
Taxation expense	10	(3.6)	(3.9)	(7.1)
Profit for the period/year		10.4	10.9	17.4

Condensed consolidated statement of recognised income and expense

	Notes	6 Months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
Profit for the period/year		10.4	10.9	17.4
Actuarial loss on retirement benefit obligations		(1.9)	(0.4)	(4.2)
Movement in deferred tax relating to retirement benefit obligations		0.5	(0.1)	0.9
Total recognised income for the period/year		9.0	10.4	14.1

All items dealt with in arriving at the profit before tax relate to continuing operations.

The accounting policies and notes on pages 13 to 24 form part of these accounts.

Condensed consolidated statement of financial position

As at 30 June 2012

	Notes	As at 30.06.12 (Unaudited) £m	As at 30.06.11 (Unaudited) £m	As at 31.12.11 (Audited) £m
Assets				
Liquid assets:				
Cash in hand and balances with the Bank of England		362.5	485.3	532.9
Loans and advances to credit institutions		164.1	51.8	172.1
Debt securities		480.1	574.3	409.7
		1,006.7	1,111.4	1,114.7
Derivative financial instruments		47.3	37.3	45.5
Loans and advances to customers:				
Loans fully secured on residential property		4,877.4	4,460.9	4,644.9
Other loans fully secured on land		525.7	555.9	530.0
Other loans		41.2	48.7	45.2
	11	5,444.3	5,065.5	5,220.1
Intangible fixed assets		2.6	2.2	2.5
Property, plant and equipment		43.2	42.4	43.7
Deferred tax assets		3.5	3.1	3.3
Other assets		5.0	3.0	4.9
Prepayments and accrued income		14.0	20.3	15.0
Total assets		6,566.6	6,285.2	6,449.7
Liabilities				
Shares		5,181.6	5,140.9	5,013.8
Deposits and debt securities:				
Amounts owed to credit institutions	13	93.9	169.5	115.4
Amounts owed to other customers		310.6	290.7	306.9
Debt securities in issue		360.3	69.2	386.3
		764.8	529.4	808.6
Derivative financial instruments		53.7	50.8	57.4
Current tax liabilities		3.9	3.6	3.1
Other liabilities		9.8	7.7	8.6
Provision for liabilities and charges	12	10.4	29.3	26.7
Accruals and deferred income		8.5	13.1	9.9
Deferred tax liabilities		0.7	1.3	1.0
Retirement benefit obligations		12.9	9.2	11.5
Subordinated liabilities		107.0	110.3	107.0
Subscribed capital		75.7	69.3	75.4
Total liabilities		6,229.0	5,964.9	6,123.0
General reserve	14	333.7	321.0	324.7
Other reserves		3.9	(0.7)	2.0
Total equity and liabilities		6,566.6	6,285.2	6,449.7

The accounting policies and notes on pages 13 to 24 form part of these accounts.

Condensed consolidated statement of cash flows

Group Interim results for six months to 30 June 2012

	6 months to 30.06.12 (Unaudited) £m	6 months to 30.06.11 (Unaudited) £m	Year ended 31.12.11 (Audited) £m
Net cash outflow from operating activities (see below)	(79.6)	(77.2)	(120.5)
Cash flows from investing activities			
Purchase of intangible assets and property, plant and equipment	(2.7)	(4.6)	(9.9)
Purchase of investment securities	(417.8)	(998.2)	(1,342.9)
Proceeds from sale and maturity of investment securities	349.8	1,223.0	1,736.1
Cash flows from financing activities			
Repurchase of subordinated liabilities	-	-	(2.0)
(Decrease)/increase in cash and cash equivalents	(150.3)	143.0	260.8
Cash and cash equivalents at beginning of period/year	651.7	390.9	390.9
Cash and cash equivalents at end of period/year	501.4	533.9	651.7
Represented by:			
Cash and balances with the Bank of England	362.3	485.3	532.9
Loans and advances to credit institutions repayable on demand	139.1	48.6	118.8
	501.4	533.9	651.7
Net cash outflow from operating activities			
Profit before taxation	14.0	14.8	24.5
Adjusted for:			
Depreciation and amortisation	3.1	3.1	6.2
Loss on sale of property, plant and equipment	-	-	0.4
Increase in impairment losses on loans and advances to customers	8.2	12.3	24.6
Change in fair values	7.4	4.7	9.4
Other non-cash movements	-	-	(0.9)
Changes in net operating assets			
Decrease/(increase) in loans and advances to credit institutions not repayable on demand	28.2	-	(50.1)
Increase in loans and advances to customers	(236.2)	(122.2)	(280.8)
Decrease/(increase) in other assets	(0.1)	0.8	(1.1)
Decrease/(increase) in prepayments and accrued income	1.0	(2.2)	3.1
(Decrease)/increase in derivative financial instruments	(5.5)	(3.5)	(5.1)
Increase/(decrease) in shares	166.3	98.7	(34.2)
(Decrease)/increase in deposits and debt securities	(45.4)	(87.8)	189.9
Increase in other liabilities	1.2	1.0	1.9
(Decrease)/increase in accruals and deferred income	(17.8)	4.9	(0.9)
Decrease in pension fund obligations	(0.5)	(0.5)	(2.0)
Taxation	(3.5)	(1.3)	(5.4)
	(79.6)	(77.2)	(120.5)

Notes to the accounts for the period ended 30 June 2012

1. Accounting policies

Basis of preparation

The condensed consolidated set of financial statements included in this half-year financial report has been prepared in accordance with the Disclosure and Transparency Rules of the Financial Services Authority and with International Accounting Standard (“IAS”) 34 ‘Interim Financial Reporting’, as adopted by the European Union. The annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union.

The same accounting policies are followed in this condensed set of financial statements as applied in the Group’s latest annual audited financial statements.

Judgements in applying accounting policies and critical accounting estimates

The same accounting judgements are followed in this condensed set of financial statements as applied in the Group’s latest annual audited financial statements and reflect management’s current estimates, except for calculations of retirement benefit obligations.

Retirement benefit obligation

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 actuaries’ assumptions used were:

	6 months to 30.06.12 (Unaudited) %	6 months to 30.06.11 (Unaudited) %	Year ended 31.12.11 (Audited) %
Discount rate assumption	4.25	5.50	4.70
Inflation assumption (RPI)	2.80	3.65	3.05
Inflation assumption (CPI)	2.00	3.15	2.25
Rate of increase in pensionable salaries	2.80	3.65	3.05

Details of the contingent element of the retirement benefit obligation can be found in Note 15c.

Going concern

The directors are satisfied that the Group has sufficient resources to continue in operation for the foreseeable future, a period of not less than 18 months from the date of this report. Accordingly, they continue to adopt the going concern basis in preparing the condensed financial statements. Further information regarding the directors’ assessment of Going Concern can be found in the Business Review on page 7.

Notes to the accounts

for the period ended 30 June 2012

2. Business segments

The Group operates four main business segments: retail financial services, commercial lending, secured personal lending, and property services.

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

	6 months to 30.06.12 (Unaudited)					
	Retail financial services	Commercial lending	Secured personal lending	Property services	Adjustment for Group transactions	Total
	£m	£m	£m	£m	£m	£m
Net interest income	26.1	4.3	17.3	-	-	47.7
Other income and charges	3.9	1.0	3.2	5.8	(1.5)	12.4
Net operating income	30.0	5.3	20.5	5.8	(1.5)	60.1
Administrative expenses	(22.1)	(1.0)	(4.9)	(5.2)	(0.8)	(34.0)
Impairment provision for losses on loans and advances	(1.7)	(4.2)	(2.3)	-	-	(8.2)
Provision for other liabilities and charges	(1.1)	-	(2.7)	(0.1)	-	(3.9)
Operating profit/(loss)	5.1	0.1	10.6	0.5	(2.3)	14.0
Other gains	-	-	-	-	-	-
Profit before taxation	5.1	0.1	10.6	0.5	(2.3)	14.0

	6 months to 30.06.11 (Unaudited)					
	Retail financial services	Commercial lending	Secured personal lending	Property services	Adjustment for Group transactions	Total
	£m	£m	£m	£m	£m	£m
Net interest income	27.0	5.5	22.0	-	-	54.5
Other income and charges	4.2	0.4	1.3	4.9	(0.2)	10.6
Net operating income	31.2	5.9	23.3	4.9	(0.2)	65.1
Administrative expenses	(20.2)	(1.0)	(5.1)	(4.7)	(2.1)	(33.1)
Impairment provision for losses on loans and advances	(1.1)	(2.5)	(8.7)	-	-	(12.3)
Provision for other liabilities and charges	-	-	(4.7)	(0.2)	-	(4.9)
Operating profit/(loss)	9.9	2.4	4.8	-	(2.3)	14.8
Other gains	-	-	-	-	-	-
Profit before taxation	9.9	2.4	4.8	-	(2.3)	14.8

Notes to the accounts

for the period ended 30 June 2012

2. Business segments (continued)

	Year ended 31.12.11 (Audited)					
	Retail financial services	Commercial lending	Secured personal lending	Property services	Adjustment for Group transactions	Total
	£m	£m	£m	£m	£m	£m
Net interest income	53.1	9.3	42.6	-	-	105.0
Other income and charges	8.3	1.1	2.6	11.0	(2.5)	20.5
Net operating income	61.4	10.4	45.2	11.0	(2.5)	125.5
Administrative expenses	(43.2)	(2.0)	(9.3)	(9.7)	(2.0)	(66.2)
Impairment provision for losses on loans and advances	(4.3)	(7.0)	(13.3)	-	-	(24.6)
Provision for other liabilities and charges	(1.5)	-	(9.3)	(0.4)	-	(11.2)
Operating profit/(loss)	12.4	1.4	13.3	0.9	(4.5)	23.5
Other gains	1.0	-	-	-	-	1.0
Profit before taxation	13.4	1.4	13.3	0.9	(4.5)	24.5

	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
Total assets by business segments			
Retail financial services	5,053.6	4,688.3	4,904.9
Secured personal lending	587.8	665.0	627.0
Commercial lending	919.7	927.1	913.0
Property services	5.5	4.8	4.8
Total assets	6,566.6	6,285.2	6,449.7
Total liabilities and reserves by business segment			
Retail financial services	5,975.3	5,615.4	5,819.3
Secured personal lending	585.8	665.0	625.6
Commercial lending	-	-	-
Property services	5.5	4.8	4.8
Total liabilities and reserves	6,566.6	6,285.2	6,449.7

Net proceeds of funding will be used by the Group for the general purposes of its business.

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

Notes to the accounts

for the period ended 30 June 2012

3. Interest receivable and similar income

	Group		
	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
On loans fully secured on residential property	118.1	116.8	237.6
On other loans fully secured on land	12.6	10.9	21.7
On debt securities	3.4	3.9	7.7
Profit on realisation of investments	0.9	0.8	0.8
On other liquid assets	1.1	1.1	2.9
On derivative financial instruments	(12.3)	(18.5)	(35.3)
	123.8	115.0	235.4

The derivative arrangements in place for the Group result in a net payment of fixed interest on mortgage related derivatives. Due to the continued low rates of LIBOR, net interest of £12.3m has been payable.

4. Interest payable and similar charges

	Group		
	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
On shares held by individuals	69.0	63.8	132.8
On other shares	0.1	0.1	-
On deposits and debt securities	8.3	5.0	12.4
On subscribed capital	2.1	2.1	4.2
On subordinated liabilities	1.1	3.0	4.1
On derivative financial instruments	(4.5)	(13.5)	(23.1)
	76.1	60.5	130.4

The derivative arrangements in place for the Group result in a net receipt of fixed interest on savings related derivatives. Due to the continued low rates of LIBOR, net interest of £4.5m has been received.

5. Fees and commission receivable

	Group		
	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
Insurance and related financial service products	5.0	4.9	7.2
Estate Agency and lettings income	2.4	2.8	4.8
Mortgage related fees	2.6	1.7	3.3
Other fees and commission	3.3	0.8	5.3
	13.3	10.2	20.6

Notes to the accounts

for the period ended 30 June 2012

6. Fees and commission payable

	Group		
	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
Mortgage related fees	0.4	0.6	1.0
Bank charges	0.2	0.2	0.4
	0.6	0.8	1.4

7. Other fair value gains and losses

	Group		
	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
Gains on derivatives	5.5	3.6	5.2
Losses on hedged items attributable to the hedged risk	(6.2)	(3.3)	(5.3)
	(0.7)	0.3	(0.1)

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

8. Administrative expenses

	Group		
	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
Wages and salaries	16.9	15.9	31.0
Social security costs	1.7	1.6	3.2
Other pension costs	0.6	0.6	1.1
	19.2	18.1	35.3
Other administrative expenses	11.7	11.9	24.7
	30.9	30.0	60.0

9. Other gains

There have been no gains relating to the sale of subordinated liabilities included in profit for the 6 months to 30 June 2012. In December 2011, the Society repurchased £3.0m of subordinated liabilities at a discount. As a result, the Group benefited from a one-off gain of £1.0m.

Notes to the accounts

for the period ended 30 June 2012

10. Taxation expense

Tax for the Group for the six month period is charged at 25.7% (30 June 2011: 26.4%), representing the best estimate of the annual effective tax rate expected for the full year, applied to the pre-tax income of the six month period. The reduction in rate is largely driven by the reduction in the UK Corporation tax rate from 26% to 24% from 1 April 2012.

11. Loans and advances to customers

	Group		
	As at 30.06.12 £m (Unaudited)	As at 30.06.11 £m (Unaudited)	As at 31.12.11 £m (Audited)
Maturity analysis of loans and advances to customers from the date of the statement of financial position:			
Less than three months	155.8	185.9	143.4
Between three months and one year	268.1	275.4	299.4
Between one year and five years	990.4	1,042.1	958.0
More than five years	4,019.1	3,543.2	3,799.1
	5,433.4	5,046.6	5,199.9
Provision for impairment losses	(65.1)	(59.6)	(63.2)
Unamortised loan origination fees	24.7	31.7	28.2
Fair value adjustment for hedged risk	51.3	46.8	55.2
	5,444.3	5,065.5	5,220.1

On 11 August 2011 the Group entered into a Residential Mortgage Backed Security (RMBS) issue, the Group's first ever external securitisation. The RMBS issue involved the formation of Friary No.1 PLC (PLC) which is consolidated into the accounts of the Group. The PLC provides security to an £814.0m amortising bond issue made by the Society as part of this issue.

At 30 June 2012, £691.8m (31 December 2011: £764.2m) of loans issued by the Society had been transferred to Friary No.1 PLC which remain on the statement of financial position of the Society as it retains the risks and rewards. These assets are treated as encumbered. The amortised value of the bond is £733.7m (31 December 11: £814.0m) of which £443.0m (31 December 2011: £514.0m) of the notes are retained by the Group. The element of the bond which is external to the Group is held within Debt Securities within the Statement of Financial Position.

The self issued securities are capable of repo financing either directly with the market or with central banks to which the Group has access. These assets are not recognised in the statement of financial position as the Group retains the risks and rewards of the mortgages.

During the first six months of the year the Group sold £50.0m of its own holding.

Notes to the accounts

for the period ended 30 June 2012

12. Provision for liabilities and charges

	Group		
	As at 30.06.12 (Unaudited) £m	As at 30.06.11 (Unaudited) £m	As at 31.12.11 (Audited) £m
At beginning of the period/year	26.7	24.8	24.8
Charge for the period/year	3.9	4.9	11.2
Utilisation	(20.2)	(0.4)	(9.3)
At end of the period/year	10.4	29.3	26.7

Provisions for liabilities are analysed as follows:

	Group		
	As at 30.06.12 (Unaudited) £m	As at 30.06.11 (Unaudited) £m	As at 31.12.11 (Audited) £m
PPI	4.2	24.3	21.6
FSCS	4.8	3.8	3.7
Regulatory and other complaints	1.4	1.2	1.4
At end of period/year	10.4	29.3	26.7

Further details of the provisions held and expected timing of payments are set out in note 15 of these Half Year Financial Statements and in note 39 to the 2011 Annual Report and Accounts.

13. Amounts owed to credit institutions

The prior period/year comparatives include £100.0m of securities sold under short-term agreements to repurchase. There are no securities sold under short-term agreements to repurchase at 30 June 2012.

Notes to the accounts

for the period ended 30 June 2012

14. Analysis of general reserve

	Group		
	As at 30.06.12 (Unaudited) £m	As at 30.06.11 (Unaudited) £m	As at 31.12.11 (Audited) £m
Balance at beginning of the period/year	324.7	310.6	310.6
Profit for the financial period/year	10.4	10.9	17.4
Actuarial loss on retirement benefit obligations	(1.9)	(0.4)	(4.2)
Movement in deferred tax relating to retirement benefit obligations	0.5	(0.1)	0.9
Total recognised income for the period/year	9.0	10.4	14.1
Balance at end of period/year	333.7	321.0	324.7
Reserves excluding pension liability	346.6	330.2	336.2
Pension liability	(12.9)	(9.2)	(11.5)
	333.7	321.0	324.7

15. Contingent liabilities and commitments

a) Financial Services Compensation Scheme levy

As described in note 39 to the 2011 Annual Report and Accounts, the Society is required to make payments to the FSCS in relation to the restructuring of a number of failed financial institutions.

A provision of £4.8m (31 December 2011: £3.7m) is held in respect of these levies and represents the Society's best estimate of total levies payable in September 2012 and 2013. The FSCS levy provision has been adjusted to reflect the most up-to-date information with regards to the 2011/12 and 2012/13 levy years which has resulted in an increase in the provision of £1.1m. The Society has not yet 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, the Society will continue to review provision levels as appropriate.

In May 2012 the International Accounting Standards Board published a draft IFRIC interpretation on 'Levies Charged by Public Authorities on Entities that Operate in a Specific Market'. The interpretation states that if a levy is triggered by the entity operating in a specific market at the end of the accounting period then the provision for the levy should be recognised at the end of the accounting period. This IFRIC applies to the FSCS levy which is based on the value of deposits at the end of the year.

The Group's approach at the half year is consistent with the draft interpretation. Based on publically available information, the levy charge for 2012 is expected to be in the region of £2.8m which will be provided for in full at the end of the year.

The FSCS originally borrowed funds from HM Treasury, which totalled approximately £18 billion, to meet the compensation costs for customers of failed financial institutions. While it is anticipated that the majority of the borrowings will be repaid wholly from recoveries from the institutions concerned, the FSCS has advised of an expected shortfall in excess of £800m. The Group's share of the shortfall is estimated to be in the region of £4.0m to £5.0m and is expected to be levied in three equal instalments beginning in 2013. The first instalment which is currently estimated at £1.5m will be provided for at the end of the year.

Notes to the accounts

for the period ended 30 June 2012

15. Contingent liabilities and commitments (continued)

b) Payment protection insurance (PPI)

As described in note 39 to the 2011 Annual Report and Accounts, the Group is required under the FSA's published Policy Statement (PS10/12) to offer redress on previously sold PPI policies in the second charge lending division.

A provision of £4.2m is held in respect of this liability, with £20.1m being utilised during the first half of the year. An additional charge of £2.7m has been incurred during the first half of the year. The remediation process is expected to be complete by the end of the year with any remaining liability largely crystallised at that point.

Provisions have not been made where the Group did not have responsibility for the original sale of the product.

c) Defined benefit pension scheme

£0.5m was injected into the Scheme during the first half of the year. The Group will inject a further £0.5m into the defined benefit pension scheme during the second half of 2012.

16. Related party transactions

Transactions between the Society and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. There were no other significant related party transactions in the current or prior period which require disclosure in the half year financial report.

Notes to the accounts

for the period ended 30 June 2012

17. Financial instruments – credit risk

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

Loans and advances to credit institutions, debt securities and derivative financial instruments

	Group		
	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
Financial assets			
Loans and advances to credit institutions	164.1	51.8	172.1
Debt securities	480.1	574.3	409.7
Loans and advances to customers	5,444.3	5,065.5	5,220.1
Derivative financial instruments			
Interest rate swaps and other derivatives	47.3	37.3	45.5
	6,135.8	5,728.9	5,847.4

In respect of loans and advances to credit institutions, debt securities and derivative instruments the percentage of these exposures that are rated between A and AAA under Fitch ratings for 2012 is 97.9% (31 December 2011: 97.1%).

Collateral is not held over loans and advances to credit institutions and debt securities. 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.

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. Collateral of £7.8m (31 December 2011: £9.1m) is held over derivative financial instruments.

Notes to the accounts

for the period ended 30 June 2012

17. Financial instruments – credit risk (continued)

Loans and advances to customers

	Group		
	6 months to 30.06.12 £m (Unaudited)	6 months to 30.06.11 £m (Unaudited)	Year ended 31.12.11 £m (Audited)
In respect of loans and advances to customers:			
Fully secured by a first charge on residential property	4,285.7	3,800.7	4,032.6
Fully secured by a first charge on land	525.7	555.9	510.7
Fully secured by a second charge on residential property	540.4	613.4	576.4
Partially secured by a second charge on residential property	41.2	48.7	45.2
Fair value adjustments	51.3	46.8	55.2
	5,444.3	5,065.5	5,220.1
Retail financial services	3,891.7	3,429.5	3,630.3
Commercial loans	919.7	927.1	913.0
Secured personal lending	581.6	662.1	621.6
Fair value adjustments	51.3	46.8	55.2
	5,444.3	5,065.5	5,220.1

The table shows loans and advances to customers disaggregated by security type and by loan type.

(a) Retail financial services and secured personal lending

Loans and advances to residential customers account for 90.3% of total loans and advances to customers (31 December 2011: 90.2%). 78.7% of loans and advances to residential customers are secured by a first charge on residential property (31 December 2011: 77.2%); 9.9% are fully secured by a second charge on residential property (31 December 2011: 10.9%).

The average index-linked loan to value (LTV) in respect of the Group's loans secured by first and second charge on residential property is 63.7% (31 December 2011: 62.6%).

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 30 June 2012, approximately 34.7% of residential exposures by account and 37.4% by value were concentrated in Wales (31 December 2011: 34.2% by account and 34.9% by value).

The percentage of residential lending cases fully secured by a first charge currently with arrears greater than 2.5% of the total outstanding balance is 0.84% (31 December 2011: 0.98%) which compares favourably with the industry average of 1.4% (latest available Council of Mortgage Lenders (CML) arrears and possessions data as at 31 March 2012).

The percentage of secured personal loans currently in arrears by number is 9.41% (31 December 2011: 9.38%), which by value is 12.50% (31 December 2011: 12.19%).

Difficult economic conditions have continued through the first half of 2012. We continue to uphold our mutual values exploring all reasonable and appropriate account management and forbearance options for borrowers experiencing financial difficulty.

The Group offers a range of account management and forbearance options for borrowers. In the event of short-term difficulty the Group operates temporary reductions in payments and 'rehabilitation' tools for borrowers in arrears or pre-delinquency. Actions may include granting a revised payment schedule, a temporary transfer to interest-only, arrangements for the borrower to underpay and changing the payment date or payment method.

Notes to the accounts

for the period ended 30 June 2012

17. Financial instruments – credit risk (continued)

(b) Commercial

Loans secured on commercial property are well diversified by industry type with the largest exposure to one counterparty amounting to £32.3m (31 December 2011: £36.9m) or 3.4% (31 December 2011: 4.0%) of gross balances.

Asset quality remains strong with total arrears balances of £0.7 (31 December 2011: £0.5m) and only 11 commercial cases (31 December 2011: 11) three months or more in arrears.

(c) Treasury

The Group has no direct exposures to Greece, Italy, Portugal, Cyprus, Ireland or Spain. Based on available information, an assessment has been made of the Society's key counterparties regarding the potential levels of indirect exposure to distressed Eurozone economies. After such an assessment, the Board has concluded that no impairment provisions are required for indirect exposures to Eurozone sovereign debt.