



# Pillar III Disclosures 2023

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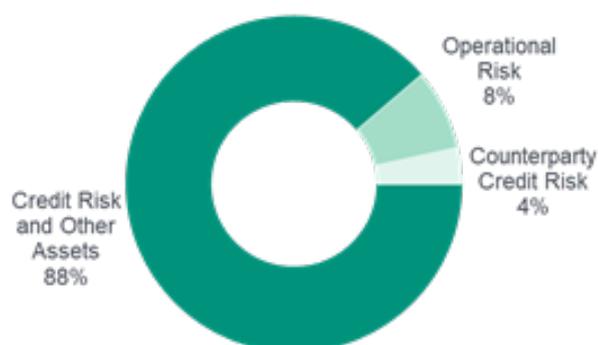
# 1. Key Regulatory Metrics (UK KM1)

	Dec 2023	Dec 2022
<b>Available own funds (amounts)</b>		
Total Common Equity Tier 1 (CET1) Capital (£m)	688.1	658.2
Tier 1 Capital (£m)	688.1	658.2
Total Capital (£m)	688.1	658.2
<b>Risk-Weighted Exposure Amounts (RWEAs)</b>		
Total Risk-Weighted Exposure Amount (£m)	3,160.0	2,483.6
<b>Capital Ratios (as a % of RWEAs)</b>		
Common Equity Tier 1 ratio (%)	21.8	26.5
Tier 1 Ratio (%)	21.8	26.5
Total Capital Ratio (%)	21.8	26.5
<b>Leverage Ratio</b>		
UK Leverage Exposure (£m)	11,596.8	10,133.1
UK Leverage Ratio (%)	5.9	6.5
<b>Liquidity Coverage Ratio</b>		
Liquidity Coverage Ratio (%)	202.8	245.6
<b>Net Stable Funding Ratio</b>		
Net Stable Funding Ratio (%)	134.6	134.5

## Notes and general information on Key Metrics

- From 1 January 2022, new regulation applicable to internally developed models has resulted in the Society applying a post model adjustment (PMA) to the Society's approved IRB model outputs. The PMA uplifts the expected loss and risk weighted exposure amounts (RWEAs) produced by the incumbent model to the expected level forecast by the redeveloped model under the new regulation. The new model is currently with the Prudential Regulation Authority (PRA) for approval. The calculations above for RWEAs and Capital Ratios and throughout the relevant sections within the document include the impact of the PMA.
- The Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) above shows an 'as at' position, further details on LCR and NSFR are covered in section 7.2. NSFR is a new disclosure requirement from 1 January 2023.
- The metrics and references in this and subsequent tables identify lines prescribed in the relevant PRA template where applicable and where there is a value.

RWEAs by risk type – 31 December 2023



Credit Risk RWEAs by Basel Approach – 31 December 2023



\*Detail on scope of permission is covered in Section 2.3.4

# 2. Overview

## 2.1 Introduction

The Capital Requirements Directive IV (CRD IV), commonly known as Basel III, came into effect on 1 January 2014 and transitional rules are in place until 31 December 2024. This document is prepared under the current Basel III rules including all transitions in place for the year ending 31 December 2023, compared with 2022 results prepared on an equivalent basis. Additionally the document states the position of the core building society and its subsidiary undertakings (the Society) as if the final Basel III rules were applied (known as the End State Basel III position).

## 2.2 Overview of Basel III

The three pillar framework of Basel II remains in place but the Basel III regulation introduced some changes to the detailed requirements within each pillar on the day it came into force.

**Pillar 1** – This is the minimum capital requirement and defines rules for the calculation of credit, market and operational risk capital requirements under the following approaches:

- o **Standardised approach:** assesses capital requirements using prescribed standard industry-wide risk weightings based on a detailed classification of asset types.
- o **Internal Ratings Based approach (IRB):** assesses capital requirements using firm specific data and internal models to calculate risk weightings. The IRB approach is further sub-divided into three approaches:
  - **Advanced IRB (A-IRB):** where internal calculations of probability of default (PD), loss given default (LGD) and credit conversion factors are used to model risk exposures.
  - **Foundation IRB (F-IRB):** where internal calculations of PD, but prescribed standardised parameters for LGD and credit conversion factors are used.
  - **Specialised Lending Exposures:** where prescribed parameters for risk weightings and expected loss are set based on an internally calculated risk grade.

**Pillar 2** – This is the supervisory review process which requires firms to undertake an Internal Capital Adequacy Assessment Process (ICAAP) for Pillar 1 and other risks not captured within Pillar 1 (see Section 4.1) and to agree total capital requirements with the regulator.

**Pillar 3** – This outlines market discipline such as requirements for disclosure of risk and capital information as specified in the Basel rules to promote transparency and sound risk management, allowing the market to assess and compare the capital adequacy of firms.

Basel III requires detailed Pillar 3 disclosures and includes generic templates to be adopted by larger financial institutions over the course of the transition to allow improved comparability and transparency between institutions covered by the Basel Accords.

Basel III has strengthened the rules on the quality of capital required to ensure loss absorption is adequate and to allow financial institutions to deal with shocks and stresses related to financial and economic factors. Basel III requires that the quality of capital to cover Pillar 1 capital requirements is improved in terms of its ability to absorb losses, meaning that more of the Pillar 1 capital requirement must be met from Common Equity Tier 1 (CET1).

## 2.3 Basis of preparation

The sole purpose of these disclosures is to give information on the basis of calculating capital requirements and on the management of risks faced by the Society. The disclosures have been prepared in accordance with the Disclosure Part of the PRA Rulebook which includes revised disclosure requirements applicable from 1 January 2022 following the UK implementation of the remaining provisions of Capital Requirements Regulation II. All calculations that include elements of own funds are prepared in line with Basel III regulation unless explicitly stated.

### 2.3.1 Frequency of disclosure

Disclosures are issued annually. Unless otherwise stated all figures are as at 31 December 2023, the Society's financial year end.

### 2.3.2 Presentation of risk data

This document discloses assets in terms of risk exposures and capital requirements. For the purposes of Pillar 3, credit exposure is defined as the estimate of the amount at risk in the event of a default (before any recoveries) or through the decline in value of an asset. This estimate takes account of contractual commitments related to undrawn amounts. In contrast, assets within the Society's statement of financial position are reported as a drawn balances only. This is the main reason that exposure values in the Pillar 3 report will differ from asset values as reported in the 2023 Annual Report and Accounts prepared in accordance with International Financial Reporting Standards (IFRS).

### 2.3.3 Scope of application

The Basel III Framework applies to the Society. This is enforced by the PRA and Financial Conduct Authority (FCA) through regulation. The Society is made up of the following trading entities:

- Principality Building Society; and
- Nemo Personal Finance Limited

Principality Building Society consolidates funding vehicles, Friary No.5 Plc, Friary No.6 Plc, Friary No.7 Plc and Friary No.8 Plc into the Society. These companies are not wholly owned by the Society but the Society retains substantially all of the risk and reward of the assets, and therefore the Society's interests in these entities are, in substance, no different than if they were 100% held subsidiary undertakings.

Full details of the Society's subsidiary undertakings are included in note 21 to the 2023 Annual Report and Accounts.

There are no differences in the basis of consolidation for accounting and regulatory capital purposes. Full details of the basis of consolidation can be found in note 1 to the 2023 Annual Report and Accounts.

### Restrictions on transfer of funds or regulatory capital

There are no legal or regulatory restrictions that constitute a material limitation on the ability of subsidiaries to pay dividends or the ability to transfer funds or regulatory capital within the Society.

### 2.3.4 Scope of permission of Internal Ratings Based Approach

The Society received PRA approval to adopt the IRB approach for credit risk in 2013. The IRB approach has been applied to first charge Retail and Commercial portfolios since 1 October 2013. The decision made during 2015 to cease new lending in Nemo Personal Finance Limited, the Society's secured personal lending business, and focus the Society's resources on the core Retail and Commercial businesses has resulted in the Society's second charge mortgages remaining on the standardised approach with the approval of the PRA.

The disclosures in this document cover both the IRB approach and the standardised approach, which applies to the secured personal lending portfolio, Residential Social Landlords (RSL) and treasury portfolios together with operational risk.

### 2.3.5 Location of risk disclosures

These disclosures have been reviewed by the Society's Audit Committee and are published on the Society's website alongside the Annual Report and Accounts ([www.principality.co.uk](http://www.principality.co.uk)).

### 2.3.6 Verification and sign-off

These disclosures are not subject to external audit except where they are equivalent to those prepared under accounting requirements for inclusion in the Society's audited Annual Report and Accounts. They are reviewed internally by the Audit Committee in accordance with the Society's policies on disclosure and its financial reporting and governance process.

### 2.3.7 Remuneration

The responsibilities and decision-making process for determining remuneration policy, the link between pay and performance and the design and structure of remuneration, including the performance pay plans, have been disclosed in the Remuneration Committee Report in the 2023 Annual Report and Accounts.

Tables required for Pillar 3 disclosures on remuneration have been included in Appendix A. These analyse the split of remuneration between fixed and variable remuneration made for those categories of staff whose professional activities have a material impact on the Society's risk profile.

Further information regarding total remuneration for each member of the identified staff is readily available if requested by the relevant authority.



# 3. Capital resources

## 3.1 Total Regulatory Capital and Reconciliation to Accounting Capital

As at 31 December 2023 and throughout the year, the Society complied with the capital requirements set out by the PRA. The following table shows the breakdown of the total available capital for the Society under the Basel III rules:

	Notes	Dec 2023 £m	Dec 2022 £m
General reserves	1	716.3	680.1
Fair value through OCI Reserve	2	0.7	(1.3)
<b>Total Accounting Capital</b>		<b>717.0</b>	<b>678.8</b>
Adjustments for Regulatory Capital:-			
Intangible assets		(19.1)	(23.5)
Additional Value Adjustment (AVA)	3	(0.9)	(0.9)
Provision deductions	4	(10.1)	(1.7)
IFRS 9 transitional adjustment	5	1.2	5.5
<b>Common Equity Tier 1 Capital</b>		<b>688.1</b>	<b>658.2</b>
<b>Total Tier 1 Capital</b>		<b>688.1</b>	<b>658.2</b>
<b>Total Tier 2 Capital</b>		<b>-</b>	<b>-</b>
<b>Total Regulatory Capital Resource</b>		<b>688.1</b>	<b>658.2</b>

### Notes and general information on Capital Resources

- The general reserve represents the Society's accumulated profits.  
Further details of the general reserve are provided in the Statement of Changes in Members' Interests in the 2023 Annual Report and Accounts.
- The Society holds unrealised gains and losses at fair value through Other Comprehensive Income (OCI). Under CRR Article 35 unrealised gains and losses at fair value should be included in own funds.
- Additional Value Adjustment (AVA) is the prudential valuation of all assets held at fair value multiplied by a prescribed percentage under the simplified calculation method which, as per CRR Article 34, is deducted from CET1 capital.
- Provision deductions arise from the use of the IRB approach. The calculation is the difference between the expected losses from the IRB portfolios and the amount of provisions held under IFRS9 for those same portfolios. CRR Article 36 states this deduction is taken from CET1 capital. The increase in provisions deductions reflects the growth of expected losses during 2023.
- The introduction of IFRS 9 in 2018 included a transitional adjustment to smooth the potential impact and volatility of the new provisioning method on capital availability. This adjustment is based on the amount of extra provisions required, taking into account any tax benefits, the result of which is multiplied by a scalar which decreases each year until 2025 at which point adjustment will be removed.

The Society does not deduct its deferred tax assets (£5.3m) that rely on future profitability from CET1. This is in line with CRR Article 48 which states that, if such assets fall below a threshold of 10% of CET1, they need not be deducted.



## 4. Capital Adequacy

### 4.1 Capital Management

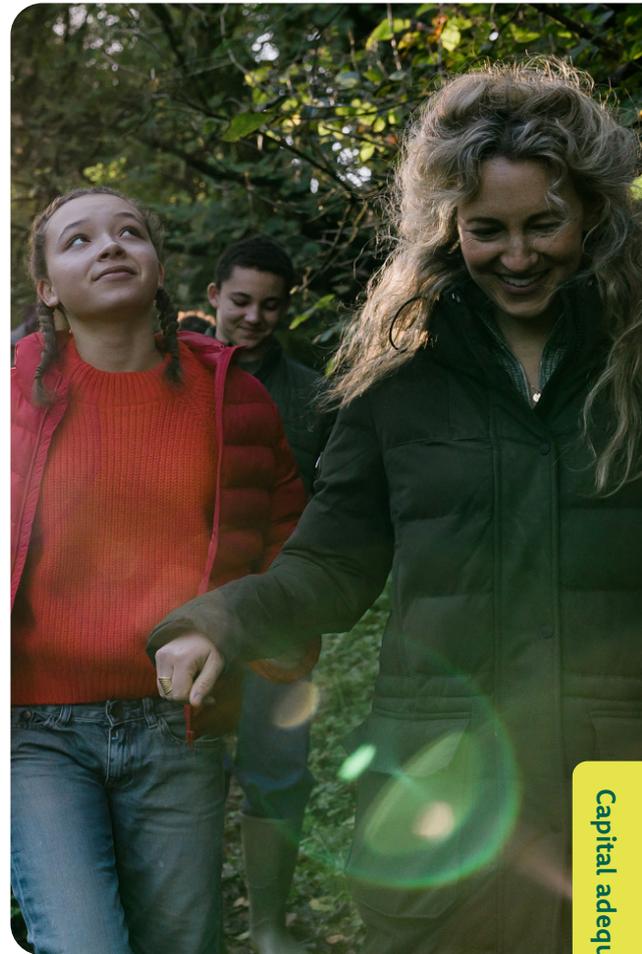
The Society uses a mixture of IRB and standardised approaches to calculate the Pillar 1 minimum capital requirement as follows:

- Retail IRB – Society first charge retail mortgages
- Specialised Lending Exposures – Commercial lending
- Standardised – Second charge mortgages, Registered Social Landlord exposures, Treasury exposures and other assets

Details of the methodologies used are included in Section 7.

Pillar 1 capital adequacy is monitored through the Board, Board Risk Committee (BRC), Executive Risk Committee (ERC) and Finance Committee (FC). Capital forecasts are formally reviewed and approved at least annually with Pillar 2 risks considered annually as part of the ICAAP.

The Society's minimum capital level is that which the Board considers necessary to protect unsecured creditors from loss and reflects the Society's planned activity as a whole, set in the competitive and economic environment in which it operates. The assessment of the minimum capital requirement is a combination of model outputs from standardised and IRB systems, supplemented by the use of other risk models, together with judgement exercised by the Board.



### Internal Capital Adequacy Assessment Process

The Society conducts an ICAAP to determine the levels of capital required to support the current and future risks faced by the Society. The ICAAP covers all material solvency risks to determine the impact of stress scenarios which are intended to meet internal and regulatory requirements. The capital requirements are presented to the Board for approval with the most recent review being completed and approved by the Board in December 2023, using 30 June 2023 as a reference date. The ICAAP is used by the PRA to determine and set the Society's Total Capital Requirement (TCR) and PRA buffer, if required. The TCR was last recalibrated by the PRA after the Society's Supervisory Review and Evaluation Process (SREP) visit in 2021, with the recalibration from the visit coming into effect in Q3 2022. The next SREP is expected to be in 2025.

The Financial Policy Committee (FPC) elected to increase the Counter-Cyclical Capital Buffer (CCyB) to 2% (previously 1%) from July 2023. At 30 June 2023 the Society's Pillar 1 and 2a TCR as a proportion of Risk Weighted Exposure Amount (RWEA) equates to 11.2% of which 6.3% has to be covered by CET1 capital. The Society is not permitted by the PRA to provide any further details regarding the individual components in respect of Pillar 2a.

The Society manages its capital above the minimum TCR threshold, including a capital buffer (further detail on which is included in Section 5.3), at all times. Capital levels for the Society are reported to, and monitored by, the Board on a regular basis.

### Regulatory environment

The Society remains confident in its ability to address the requirements associated with the implementation of emerging regulation over the planning horizon. The Society transitioned to the PRA requirements for Pillar 3 disclosures effective from 1 January 2022.

The Credit Risk Control Unit (CRCU) has redeveloped and submitted the Retail IRB models in Q4 2023 working closely with the Regulator to ensure these met expectations, including changes to the definition of default and model cyclicity.

The regulator has requested that IRB firms still relying on incumbent IRB models after January 2022 should apply a post model adjustment (PMA). This should reflect the expected eventual uplift in risk weights and expected losses and associated Pillar 1 capital requirements introduced by the new regulations.

## Regulatory environment (continued)

We regularly review the appropriateness of the uplift, the latest assessment took place in December 2023 which resulted in an increase to the PMA applied at December 2023. The appropriateness of the PMA will continue to be reviewed on a regular basis until the new models have been approved and implementation of them completed.

In December 2023, the first of two near-final policy statements covering the implementation of Basel 3.1 was released by the PRA. The near-final rules are designed to implement elements of the final package of banking prudential reforms developed by the Basel Committee on Banking Supervision in response to the global financial crisis. The first Policy Statement covers updated standards for market risk, credit valuation adjustment risk, counterparty credit risk and operational risk. The second policy statement is due for release in Q2 2024.

A cross function working group has been set-up with key colleagues to review the impact to the Society and implement the changes of Basel 3.1 due from 1 July 2025. The rules have a 4.5 year transitional period with full implementation due by 1 January 2030.

The aim of Basel 3.1 is the advancement of the PRA's primary objective of promoting the safety and soundness

of the firms it regulates and make firms' capital ratios more consistent and comparable.

In May 2023, the PRA released Supervisory statement 1/23 Model Risk management principles. Model risk is already an area of focus for the Society, following the release of the statement the Society has aligned its efforts to the specific requirements of that statement. This has included the creation of two sub-committees responsible for Financial Model Governance (FMGC) which report to the Model Governance Committee (MGC).

SS1/23 sets out the PRA's expectations for management of model risk and how it is approached as a risk discipline in its own right. The expectations set out are overarching principles which are effective from May 2024.

The previously announced FPC change to the Counter-Cyclical Capital Buffer (CCyB) completed, with the final increase of 1% in July 2023 to 2%.

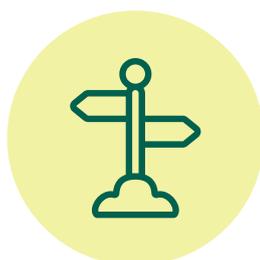
All changes have been considered and continue to be assessed as further details are made available by the regulatory bodies. The Society is satisfied that current forecast levels of capital are sufficient to meet associated requirements.

## IFRS 9

In line with accounting requirements of IFRS, the Society calculates provisions under IFRS 9. The PRA advised that all financial institutions should make use of a transitional adjustment to smooth the potential impact and volatility of the new provisioning method; the Society makes use of the transition.

For relevant provisions raised from January 2020, the CET1 add-back percentages were set at 100% in 2021, 75% in 2022, 50% in 2023, and 25% in 2024. The CET1 add-back has decreased for the year see section 5.2 below.

Further information on IFRS 9 is available in notes 1 and 19 of the 2023 Annual Report and Accounts.



## Capital Requirement

The Society's capital requirement under Pillar 1 is calculated by applying appropriate risk weightings to each class of exposure, then applying a fixed 8% multiplier.

### Overview of risk weighted exposure amounts (UK OV1)

	Average Risk Weights Dec-2023 %	Risk Weighted Exposure Amount Dec-2023 £m	Capital Requirement Dec-2023 £m	Average Risk Weights Dec-2022 %	Risk Weighted Exposure Amount Dec-2022 £m	Capital Requirement Dec-2022 £m
<b>Credit Risk – IRB Approach</b>						
Retail financial services	20	2,102.6	168.2	16	1,534.8	122.8
Retail financial services - Past due items	158	5.8	0.5	165	3.8	0.3
Commercial lending - Non housing associations	85	553.2	44.3	81	531.3	42.5
<b>Credit Risk – Standardised Approach</b>						
Commercial lending - Housing associations	35	79.1	6.3	35	69.6	5.6
Financial institutions	24	90.9	7.3	19	41.9	3.4
Fixed and other assets	162	13.2	1.1	129	7.2	0.6
Secured personal lending	37	21.4	1.7	37	27.2	2.2
Secured personal lending - Past due items	100	5.8	0.4	100	6.8	0.5
Covered bonds*	10	18.9	1.5	50	48.7	3.9
Credit risk minimum capital requirement		2,890.9	231.3		2,271.3	181.8
CVA		24.2	1.9		4.7	0.4
Operational risk		244.9	19.6		207.6	16.6
Total minimum capital required		3,160.0	252.8		2,483.6	198.8
Total own funds			688.1			658.2
Excess of own funds over minimum capital requirement under Pillar 1			435.3			459.4

\*Covered bonds risk weight was adjusted following a change in judgement on the credit quality of the investments resulting in a lower risk weight in 2023.

### Notes and general information on overview of risk weighted exposure amounts

1. Impaired/past due items for commercial specialised lending are risk weighted at 0% as prescribed by CRD IV, these loans also attract an expected loss of 50% of the balance.

## 4.2 Movements in RWEA

During the year, we regularly review the appropriateness of the uplift, the latest assessment took place in several factors which include House Price Index (HPI) movements, the PMA and mortgage book growth has resulted in an increase in the Society's total RWEA. The below table shows the movement in the year of the total RWEA under a capital calculation approach:

	£m
Position as at 31 December 2022	2,483.6
Increase due to net mortgage book growth	441.5
Increase due to retail IRB PMA	103.2
Increase due to IRB asset quality	49.9
Increase due to treasury assets	18.7
Increase due to other assets	6.3
Increase in operational risk	37.3
Increase of CVA	19.5
Position as at 31 December 2023	3,160.0

The increase in net mortgage book growth of £441.5m reflects the RWEA of the mortgage book growth inclusive of the PMA adjustment as at 31 December 2023. Mortgage book growth in the year has an increased overall RWEA where new members coming on book have a higher risk weight than members that have redeemed in the year.

The decreases in HPI throughout the year has also had an impact on the increased RWEA at 31 December 2023. The HPI decrease results in an increase to the Balance to Value (BTV) related to mortgages which increased the risk weights associated. The movement in risk profile of £49.9m only includes loans that were active at 31 December 2022 and still active at 31 December 2023.

The increase in operational risk of £37.3m is solely down to the formulaic calculation of risk weights for operational risk which relies on the average income over the past 3 years, which has increased due to the Society's financial performance.

### The risk weighted exposure amount of credit exposures under the IRB approach (UK CR8):

	£m
Risk weighted exposure amount as at 31 December 2022	2,069.8
Asset size (+/-)	438.9
Asset quality (+/-)	49.9
Model updates (+/-)	103.2
Risk weighted exposure amount as at 31 December 2023	2,661.8

Increases in asset size was driven by the growth to Retail Financial Services in the year.

Model updates refer to the new regulation applicable from 1 January 2022 in relation to internally developed IRB models which has resulted in the Society applying a PMA. The PMA uplifts the expected loss and risk weighted exposure amounts (RWEAs) produced by the incumbent regulatory models to the level forecast by the newly developed models pending finalisation and approval from the PRA.



## 5. Continued Impact of Basel III

The Basel III rules, referred to as CRD IV, took effect on the Society from 1 January 2014. The key impacts are outlined below.

### 5.1 Quality of Capital

The objectives of the rules are to increase the ability of financial institutions to deal with shocks and stresses related to financial and economic factors. To achieve the objectives the definition of capital was restated and in particular includes specific requirements relating to the ability of firms to absorb losses. CET1 is regarded as the highest quality of capital and Basel III rules state that a greater proportion of the Pillar I capital requirement must be met from CET1 (as of 1 January 2015, 4.5% of the total 8.0%).

### 5.2 Impact - Composition of regulatory own funds (UK CC1)

The continued impact of Basel III has been fully assessed to demonstrate that the Society will remain well capitalised over its planning horizon. The table below shows the Society's capital position prepared in accordance with the Basel III rules to date, transitional rules for the coming year and the final position.

Common Equity Tier 1 (CET1) capital: instruments and reserves	Notes	Basel III 31.12.2023 £m	Adjustments £m	Transitional Basel III Rules 01.01.2024 £m	End Transition Rules 01.01.2025 £m
General and other reserves		717.0	-	717.0	717.0
Common Equity Tier 1 (CET1) capital before regulatory adjustments		717.0	-	717.0	717.0
Common Equity Tier 1 (CET1) capital: regulatory adjustments					
Additional value adjustments		(0.9)	-	(0.9)	(0.9)
Intangible assets		(19.1)	-	(19.1)	(19.1)
Negative amounts resulting from the calculation of expected loss amounts		(10.1)	-	(10.1)	(10.1)
IFRS 9 transitional adjustment	1	1.2	(0.6)	0.6	-
Total regulatory adjustments to Common Equity Tier 1 (CET1)		(28.9)	(0.6)	(29.6)	(30.2)
Common Equity Tier 1 (CET1) capital		688.1	(0.6)	687.5	686.9
Additional Tier 1 (AT1) capital		-	-	-	-
Tier 1 capital (T1 = CET1 + AT1)		688.1	(0.6)	687.5	686.9
Total capital (TC = T1 + T2)		688.1	(0.6)	687.5	686.9
Total risk weighted exposure amount		3,160.0	-	3,160.0	3,160.0

Capital ratios and buffers	Notes	Basel III 31.12.2023 %	Adjustments %	Transitional Basel III Rules 01.01.2024 %	End Transition Rules 01.01.2025 %
Common Equity Tier 1 (as a percentage of total risk exposure amount)		21.8	(0.0)	21.8	21.7
Tier 1 (as a percentage of total risk exposure amount)		21.8	(0.0)	21.8	21.7
Total capital (as a percentage of total risk exposure amount)		21.8	(0.0)	21.8	21.7
Institution specific buffer requirement					
Common Equity Tier 1 available to meet buffers (as % of risk exposure amount)				10.8	10.8

Amounts below the thresholds for deduction (before risk weighting)	Notes	Basel III 31.12.2023 £m	Adjustments £m	Transitional Basel III Rules 01.01.2024 £m	End Transition Rules 01.01.2025 £m
Deferred tax assets arising from temporary differences		5.3	-	5.3	5.3

Applicable caps on the inclusion of provisions in Tier 2	Notes	Basel III 31.12.2023 £m	Adjustments £m	Transitional Basel III Rules 01.01.2024 £m	End Transition Rules 01.01.2025 £m
Cap on inclusion of credit risk adjustments in T2 under standardised approach		6.2	-	6.2	6.2
Cap for inclusion of credit risk adjustments in T2 under IRB approach		12.8	-	12.8	12.8

### Notes and General Information on Basel III Impacts

1. IFRS 9 Transition is still in effect at 1 January 2023 when final Basel III rules become effective and will fall to zero from 2025.

### 5.3 Capital buffers

To encourage adequate build-up of loss absorbing capital that can be used in times of stress, Basel III requires the use of CET1 capital buffers, expressed as a percentage of total RWEAs. A Capital Conservation Buffer (CCB) of 2.5% can be supplemented by regulators with a Counter-Cyclical Capital Buffer (CCyB).

The Counter-Cyclical Capital Buffer is designed to provide additional loss coverage based on the current economic environment. The FPC increased the CCyB to 1% in December 2022 and to 2% in July 2023. The level of this buffer has now returned to pre COVID-19 level.

The PRA undertake a SREP to review the adequacy of the Society's capital requirements for all relevant risks. The outcome of the process is reflected in the calculation of TCR and, where deemed appropriate, a PRA buffer in addition to the other regulatory buffers.

The PRA buffer defines the minimum level of capital buffer over and above the minimum regulatory requirement that should be maintained in non-stressed conditions. This is designed to mitigate against possible stress periods in the future. The PRA requires that the level of this buffer is not publically disclosed.

The available CET1 capital as a percentage of RWEAs to meet these buffers is shown in Section 5.2.

## Capital buffers (continued)

Due to the nature of the Society's capital structure, all high quality CET1, the Society currently operates with an excess over the regulatory minimum and continues to be able meet minimum requirements over the longer term planning horizon.

### 5.4 Leverage

Leverage is a non-risk based ratio to supplement the risk based capital requirements. The ratio shows Tier 1 capital as a proportion of on and off balance sheet assets. The ratio does not distinguish between the credit quality of loans and acts as a primary constraint to excessive lending in proportion to the capital base.

The PRA's UK leverage ratio framework, allows institutions within its scope to exclude Bank of England assets from their leverage calculations; however, as a result the PRA expects the minimum ratio to be 3.25%. A Counter-Cyclical Leverage Ratio Buffer (CCLB) applies under these regulations; institutions are required to hold 35% of their CCyB as a CCLB.

The Society is not within scope of the UK leverage framework, however the regulator expects all institutions to meet the ratio and the Society's ratio of 5.93% is well above the minimum requirements.

Under CRR II, the PRA announced a move away from the use of the EBA requirement for the Leverage Ratio, with the UK Leverage Ratio now applying to UK Financial institutions from 1 January 2023.

	Notes	Dec-2023 £m	Dec-2022 £m
<b>Total Assets as per Statutory Accounts</b>		<b>12,526.6</b>	<b>11,257.3</b>
<b>Adjusted for:</b>			
Adjustments for Derivative financial instruments	1	(232.4)	(100.5)
Off balance sheet exposures with a 50% CCF - Commercial lending commitments		60.9	84.8
Off balance sheet exposures with a 100% CCF - Retail commitments		643.1	477.4
Regulatory adjustment for Intangibles		(19.1)	(23.5)
Regulatory adjustments for AVA		(0.9)	(0.9)
Provision deductions		(10.1)	(1.7)
IFRS 9 Transitional Adjustment		1.2	5.5
Claims on central bank		(1,372.5)	(1,565.3)
<b>UK Leverage Exposure</b>		<b>11,596.8</b>	<b>10,133.1</b>
Tier 1 capital (transitional position)	2	688.1	658.2
Tier 1 capital (end state position)	3	686.9	652.7
UK Leverage ratio framework using transitional Tier 1 Capital		5.93%	6.50%
UK Leverage ratio framework using end state Tier 1 Capital	3	5.92%	6.44%

### Notes and General Information on Basel III Impacts

- The adjustment for derivative financial instruments of £232.4m relates to the regulatory change in methodology in calculating derivative exposures in 2023.
- The transitional position represents the Tier 1 capital and Leverage ratio at 31 December 2023 following Basel III transitional provisions.
- 2022 end state position has been restated following correction being required to the Tier 1 capital and Leverage ratio in the disclosure.

## 5.5 Capital Adequacy through Transition

	Basel III 31.12.2023 £m	Transitional Basel III Rules 01.01.2024 £m	End Transition Rules 01.01.2025 £m
Total minimum capital required	252.8	252.8	252.8
Total own funds	688.1	687.5	686.9
Excess of own funds over minimum capital requirement under Pillar 1	435.3	434.7	434.1

The Bank of England announced rules in November 2016, with an update in April 2023, which are designed to manage the failure of banks and building societies in a more orderly and effective way. Minimum Required Eligible Liabilities (MREL) represents one element of a series of wider reforms intended to prevent future taxpayer bail-outs in the UK.

MREL requirements are split into two elements. Firstly, a loss absorption amount, to cover losses up to and in resolution, based on a firm's minimum going concern capital requirement. Secondly, a recapitalisation amount, to enable the firm to continue post resolution, likely to be at least equal to the minimum going concern capital requirement. There are no additional MREL requirements over and above the Society's current TCR.



# 6. Risk Management Objectives and Policies

## 6.1 Overview

The Society is primarily a provider of financial products, mainly in the form of mortgages and savings. These products give rise to a financial asset or liability and are termed financial instruments. As well as mortgages, savings and secured personal loans, the Society also uses wholesale financial instruments to invest liquid asset balances, raise wholesale funding and to manage interest rate risk arising from its operations.

The Society is exposed to a diverse range of risks in the execution of its strategy and in undertaking day-to-day activities. These risks are mitigated to an extent by the straightforward nature of the business model and the range of products offered. The Society's culture and risk management philosophy reflects a strong awareness of the current and emerging risk landscape which could affect the delivery of its strategy. The Society operates solely within the UK and takes risks only where they can be fully understood, monitored and mitigated.

The Society's principal business objective is to provide Members with the benefits of a mutual organisation through the design, manufacture and delivery of savings and mortgage products. The key risks to which the Society is exposed include business risk (including reputational risk), credit risk, liquidity and funding risk, market risk, operational risk, solvency risk, conduct risk and legal and regulatory risk. These are fundamentally unchanged from those reported in the prior year, but in many respects their potential impact on the inherent risk profile of the business remains elevated as a consequence of both the challenging macro-economic environment and the uncertainty arising from the Cost of Living Crisis.

Alongside the principal risks detailed above, the Society's exposure to emerging and evolving risks is closely monitored through a formal governance structure that includes measuring performance against key risk indicators. Regular horizon scanning activity is undertaken to identify any new or emerging risks that could threaten the long-term viability of the business.

The financial risks arising from climate change are assessed and reflected within the Society's Enterprise Risk

Management framework. When assessing the impact of climate change on principal risks, the Society considers the potential 'transition' risks i.e. those that arise from the adjustment towards a low carbon economy, and 'physical' risks that relate to the increasing severity and frequency of climate and weather-related events.

As the Society's understanding of the risks posed by climate change continues to evolve, the Society will take into account the potential impact on the business and its customers, recognising that the risks associated with climate change will persist and evolve over time. The Board Risk Committee (BRC) and Executive Risk Committee (ERC) are responsible for the oversight of the financial risks arising from climate change and the risk is managed through the Enterprise Risk Management Framework and the ICAAP process. A specific capital add-on is not considered appropriate at this point.

Climate change considerations are embedded strategically in the Society's governance model and future planning, and the Society has completed the analysis of the current book in line with regulation. More focus is expected on climate change management as expectations of the regulators, members and other stakeholders continue to evolve.

In 2023, a 'climate' flag was added to the Society's Risk Register and an initial review identified 14 high-level risks within the existing framework which could be impacted by climate change. Risk Owners consider the impact of climate change during their quarterly review assessment of these and all risks.

Further information in relation to the steps taken to mitigate these risks are published in the Taskforce on Climate-related Financial Disclosures (TCFD) on the Society's website, together with the Climate-related Financial Disclosure Regulations section of the 2023 Annual Reporting and Accounts.

Further detail on the key risks and the emerging risks together with how these are mitigated can be found in Section 7 below and in the 2023 Annual Report and Accounts.

### The ways in which the Society manages these risks include:

- operating a single integrated business model underpinned by strong risk governance;
- adopting a risk management framework which covers all risks and is supported by a clearly defined 'three lines of defence' model;
- monitoring and managing risks within risk appetite as set by the Board; and
- ensuring the Society maintains sufficient capital and liquidity to enable the business to survive a combination of severe but plausible market and firm specific stresses.

## 6.2 Risk Appetite

The Board approves risk appetite statements identifying and defining the types and levels of risk it is willing to accept in the pursuit of its strategic goals. This provides the business with a framework within which decision making and planning can be undertaken.

Board risk appetite statements are linked to the Society's strategy and are supported by a broad suite of Board level risk metrics, appetites and tolerances, designed to monitor the Society's exposure to key prudential and conduct related risks. These are set in a hierarchy that links the Board's tolerance for risk to its strategic goals, medium-term plans and 'business as usual' activities. The Society has decided to omit disclosing key ratios and figures relating to its risk appetite, as they are considered to be proprietary information as per CRR article 432.

## 6.3 Risk Management Structure

The Society adopts a 'three lines of defence' model ensuring clear independence of responsibilities for risk control, oversight and governance. This is summarised below:

- First line of defence – Every employee is responsible for managing the risks which fall within their day-to-day activities. The first line of defence ensures all key risks within their operations are identified, monitored and mitigated by appropriate controls.
- Second line of defence – Dedicated teams within the Society's Risk and Compliance functions are responsible for providing independent oversight and challenge of activities conducted in the first line.
- Third line of defence – The Society's Internal Audit function provides independent assurance of the activities in both the first and second lines of defence.

## 6.4 Risk Governance

The Board of Directors is responsible for the overall framework of risk governance and management of the Society. The Board is responsible for determining risk strategy and ensuring that risk is monitored and controlled effectively. It also has responsibility for establishing a clearly defined risk management structure with distinct roles and duties.

Within the risk structure set by the Board line managers are accountable for the identification, measurement and management of the risks within their areas of responsibility. Risk governance is provided by a structure consisting of six key risk management committees. Each committee has appropriate representation drawn from Executive, divisional management and risk specialists.

### Executive Risk Committee

The Executive Risk Committee (ERC) is chaired by the Chief Risk Officer and is responsible for oversight and monitoring of all prudential and conduct risks across the Society and reviewing risk exposures.

### Credit Risk Committee

The Credit Risk Committee (CRC), chaired by the Head of Prudential Risk, is responsible for monitoring and reviewing exposure to credit risks in the Society's retail and commercial loan portfolios.

### Operational Risk Committee

The Operational Risk Committee (ORC), chaired by the Head of Enterprise Risk, is responsible for monitoring and reviewing exposure to operational and financial crime risks arising from the Society's day-to-day activities.

### Model Governance Committee

The Model Governance Committee (MGC), chaired by the Chief Financial Officer, is responsible for approval and oversight of models used by the Society to assess and quantify exposure to credit risk and to assist in the quantification of impairment provisions required under IFRS 9. The MGC is the designated committee for the approval and maintenance of the IRB rating system.

### Finance Committee

The Finance Committee (FC), chaired by the Chief Financial Officer, in addition to its financial management responsibilities, has responsibility for the assessment and management of financial risks and relevant risk appetites.

### Compliance and Conduct Committee

The Compliance and Conduct Committee (CCC), chaired by the Head of Compliance and Conduct Risk is responsible for monitoring and reviewing exposure to conduct risks arising from the Society's day-to-day activities.



### 6.4.1 Board Risk Committee

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 operates through its regular meetings and four committees – Remuneration, Governance and Nominations, Audit and Board Risk Committee. Chaired by a Non-Executive Director, the Board Risk Committee (BRC) has responsibility for ensuring a Society-wide co-ordinated approach towards the oversight and management of principal risks. It will consider and recommend to the Board matters involving risk appetite, capital and liquidity adequacy and is also responsible for maintaining an appropriate governance structure to ensure that risks across the Society are identified and managed effectively.

Further information on Board Committee Terms of Reference can be found on the website [principality.co.uk](http://principality.co.uk). This includes frequency of meetings, committee functions and reporting to or from the committees. Terms of Reference are also held internally for all committees within the Society.

Further details on risk governance are included in the Board Risk Committee Report in the 2023 Annual Report and Accounts.

## 6.5 Stress Testing

The Society undertakes stress testing, scenario analysis and contingency planning to understand the impact of unlikely, but severe risk events, to better enable it to react should events of this severity occur. A range of multi-risk category stress tests, reverse stress tests and operational risk scenario analyses are undertaken with the results forming a central component of the Society's capital and liquidity adequacy assessments.

Reverse stress testing is a key component of the Society's existing stress testing framework and considers extreme events that could result in failure of the Society. A qualitative approach is used to explore potential scenarios, which, if crystallised, could result in failure of the Society. This is supplemented by quantitative assessments which determine the potential impact to the Society's capital or liquidity arising as a consequence of the scenarios. A key outcome from the process is to consider whether any

of the scenarios considered are sufficiently plausible to necessitate a change to the Society's strategy, require mitigating actions to be taken, or require supplementary management information to monitor the likelihood of crystallisation.

The Society is aware of the potential long-term risks which climate change represents to its business model and to the wider economy. The Society's stress testing framework includes the assessment of the financial risks emanating from climate change which takes into account current relevant risks in addition to those which may plausibly arise in the future. The Society will take a strategic approach to managing the financial risks arising from climate change based on the outcome of assessments undertaken. The Board Risk Committee will review the output of these assessments and re-appraise the approach to the management and mitigation of the associated risks where necessary.

### 6.6 Recovery and Resolution Plan

The UK and European regulatory authorities require all banks and building societies to formulate recovery and resolution plans to minimise both the risk of failure and the impact of failure on the wider economy. The recovery plan outlines the steps the Society can take to prevent failure whilst the resolution plan includes the data required by the Bank of England to establish an orderly resolution of the Society's affairs, in the event that recovery cannot be achieved.

The process of preparation for such extreme events enables the Board to plan actions it would take to recover from adverse conditions which would otherwise lead to failure. The recovery plan represents a 'menu of options' for the Society to deal with firm-specific or market-wide stresses and which can be incorporated into a credible and executable plan.



# 7. Principal Risk Measurement, Mitigation and Reporting

## 7.1 Credit Risk Overview

Credit risk is the risk that a customer or counterparty will fail to meet their financial obligations to the Society as they become due. The Society faces this risk primarily from loans to residential customers, loans to commercial customers and from the assets held by the Balance Sheet Management function in order to meet liquidity requirements and for general business purposes.

The controlled management of credit risk is critical to the success of the Society's lending strategy. The quality of individual lending decisions and subsequent management and control, together with the application of a credit policy that reflects the risk appetite of the Society, have a direct impact on the achievement of the Society's strategy. Each of the business areas, residential first charge lending, commercial lending and treasury, has its own

individual Credit Risk Policy Statement setting out the Board's risk appetite including policy scope, structures and responsibilities, definitions of risk and risk measurement and approach to monitoring.

Day-to-day management of credit risk is undertaken by specialist teams, using credit risk management techniques adopted as part of the Society's overall approach to measure, mitigate and manage credit risk in a manner consistent with the risk appetite approved by the Board. Credit risk portfolios are subject to regular stress testing to simulate outcomes and assess the potential impact on capital requirements.

Further details of credit risk governance are included in the Risk Overview Section in the 2023 Annual Report and Accounts.

### 7.1.1 Exposures

Exposure at Default (EAD), as shown in these credit risk disclosures, is defined as the exposure value under regulatory definitions for capital purposes. EAD is an estimate of the expected utilisation of a credit facility and will be equal to or greater than the currently drawn exposure excluding any Basel III defined credit risk mitigation (CRM).

	EAD Pre-CRM Dec-2023 £m	EAD Post-CRM* Dec-2023 £m	RWEAs Dec-2023 £m	Capital Required Dec-2023 £m
Retail financial services	10,324.7	10,324.7	2,108.4	168.7
Secured personal lending	62.9	62.9	27.2	2.1
Commercial lending	882.3	882.3	632.3	50.6
	<b>11,269.9</b>	<b>11,269.9</b>	<b>2,767.9</b>	<b>221.4</b>
<b>Treasury</b>				
Central governments or central banks <sup>^</sup>	1,372.5	1,372.5	-	-
Multilateral development banks <sup>^</sup>	24.1	24.1	-	-
Financial institutions	564.3	564.3	109.8	8.8
	<b>1,960.9</b>	<b>1,960.9</b>	<b>109.8</b>	<b>8.8</b>
Other assets	8.1	8.1	13.2	1.1
<b>Total</b>	<b>13,238.9</b>	<b>13,238.9</b>	<b>2,890.9</b>	<b>231.3</b>

### Notes and General Information on Exposures

\* CRM continues not to be relevant to the Society's exposures in 2023.

<sup>^</sup> Central governments, central banks and multilateral development banks have a risk weight of 0%.

The geographical distribution of these exposures at 31 December 2023 is as follows:

EAD Pre-CRM	UK £m	Other Countries £m	Total £m
Retail financial services	10,324.7	-	10,324.7
Secured personal lending	62.9	-	62.9
Commercial lending	882.3	-	882.3
	<b>11,269.9</b>		<b>11,269.9</b>
<b>Treasury</b>			
Central governments or central banks	1,372.5	-	1,372.5
Multilateral development banks	-	24.1	24.1
Financial institutions	564.3	-	564.3
	<b>1,936.8</b>	<b>24.1</b>	<b>1,960.9</b>
Other assets	8.1	-	8.1
<b>Total</b>	<b>13,214.8</b>	<b>24.1</b>	<b>13,238.9</b>

The following table shows the residual maturity of the exposures at 31 December 2023. The maturity of exposures is shown on a contractual basis. This does not take into account any capital repayments receivable over the life of the exposure.

EAD Pre-CRM	Up to 12 months	1-5 years	More than 5 years	Total
Retail financial services	35.9	324.0	9,964.8	10,324.7
Secured personal lending	6.0	2.3	54.6	62.9
Commercial lending	9.3	433.5	439.5	882.3
	<b>51.2</b>	<b>759.8</b>	<b>10,458.9</b>	<b>11,269.9</b>
<b>Treasury</b>				
Central governments or central banks	1,372.5	-	-	1,372.5
Multilateral development banks	24.1	-	-	24.1
Financial institutions	246.2	317.8	0.3	564.3
	<b>1,642.8</b>	<b>317.8</b>	<b>0.3</b>	<b>1,960.9</b>
Other assets	2.8	-	5.3	8.1
<b>Total</b>	<b>1,696.8</b>	<b>1,077.6</b>	<b>10,464.5</b>	<b>13,238.9</b>

The following table shows the Society's exposures that are subject to the standardised or IRB approach:

EAD Pre-CRM	Total Exposure Value as Defined in Article 166 CRR Dec-2023 £m	Total Exposure Value Subject to SA and IRB Dec-2023 £m	Percentage of Total Exposure Value Subject to Permanent Partial Use of SA Dec-2023 %	Percentage of Total Exposure Value Subject to IRB Approach Dec-2023 %
Central governments or central banks	1,397.2	1,396.5	100	-
Institutions	572.9	572.4	100	-
Corporates	699.5	656.1	-	100
Of which Corporates – Specialised lending under slotting approach	694.6	656.1	-	100
Retail*	10,298.2	10,613.9	3	97
Of which Retail – Secured by real estate non-SMEs	10,298.2	10,613.9	3	97
<b>Total</b>	<b>12,967.8</b>	<b>13,238.9</b>	<b>17.1</b>	<b>82.9</b>

\*3% of Retail being subject to standardised methodology relates to Nemo residential mortgages and commercial housing association.

#### Standardised approach – Credit risk exposure and CRM effects (UK CR4)

EAD Pre-CRM	EAD Pre-CRM		EAD Post-CRM*		RWEAs Dec-2023 £m	RWEAs Density <sup>^</sup> Dec-2023 %
	On-balance-sheet Dec-2023 £m	Off-balance-sheet Dec-2023 £m	On-balance-sheet Dec-2023 £m	Off-balance-sheet Dec-2023 £m		
Central governments or central banks	1,372.5	-	1,372.5	-	-	-
Multilateral development banks	24.1	-	24.1	-	-	-
Institutions	374.9	-	374.9	-	90.6	24.2
Retail	2.3	-	2.3	-	1.7	75.0
Secured by mortgages on immovable property	264.9	17.5	264.9	17.5	98.9	35.0
Exposures in default	5.8	-	5.8	-	5.8	100.0
Covered bonds	189.4	-	189.4	-	18.9	10.0
Other items	8.1	-	8.1	-	13.2	162.5
<b>Total</b>	<b>2,242.0</b>	<b>17.5</b>	<b>2,242.0</b>	<b>17.5</b>	<b>229.1</b>	<b>10.1</b>

#### Notes and General Information on Exposures

\* CRM continues not to be relevant to the Society's exposures in 2023.

<sup>^</sup> RWEAs Density is calculated by the RWEA divided by the total EAD Post-CRM.

## 7.1.2 Residential Mortgage Credit Risk

Credit risk is inherent in the Society's residential mortgage portfolio. Credit risk is assessed both for the Society's existing mortgage assets and also for mortgage lending to which the Society is committed, for example through a firm commitment to lend against a mortgage offer or through a facility to increase the amount of lending on an existing mortgage.

The Society will continue to keep its lending criteria under constant review, reviewing loan to value (LTV) and loan to income (LTI) maxima where and when appropriate.

The Society's residential mortgage portfolio is managed using a rating system which has been developed in line with the IRB approach to credit risk as described below.

The following table shows the Society's exposure to first charge retail mortgages under IRB split by PD bands at 31 December 2023:

IRB approach – Credit risk exposures by exposure class and PD range (UK CR6)

PD Bands %	Exposure at Default Dec-2023 £m	Exposure Weighted Average PD* Dec-2023 %	Number of Obligors Dec-2023 #	Exposure Weighted Average Loss Given Default Dec-2023 %	Risk Weighted Exposure Amount Dec-2023 £m	Expected Loss Amount Dec-2023 £m
<b>0.00 to&lt;0.15</b>	6,891.0	0.09	56,701	20.32	959.5	3.0
0.00 to<0.10	4,950.0	0.07	40,317	19.03	629.4	1.5
0.10 to<0.15	1,941.0	0.15	16,384	23.62	330.1	1.5
<b>0.15 to&lt;0.25</b>	1,407.5	0.24	10,522	27.33	314.9	2.0
<b>0.25 to&lt;0.50</b>	1,393.3	0.43	12,247	25.51	396.1	3.5
<b>0.50 to&lt;0.75</b>	263.9	0.83	2,141	33.72	127.8	1.6
<b>0.75 to&lt;2.50</b>	214.8	1.63	1,889	28.35	127.5	2.1
0.75 to<1.75	189.5	1.47	1,630	28.65	108.4	1.7
1.75 to<2.50	25.3	2.82	259	26.07	19.1	0.4
<b>2.50 to&lt;10.00</b>	82.7	13.30	759	22.22	98.6	5.1
2.50 to<5.00	18.7	4.71	179	27.17	18.6	0.5
5.00 to<10.00	64.0	15.81	580	20.78	80.0	4.6
<b>10.00 to&lt;100.00</b>	43.2	55.67	464	17.69	39.2	8.8
10.00 to<20.00	5.7	18.85	53	21.05	7.5	0.5
20.00 to<30.00	15.7	42.53	175	18.97	18.7	2.8
30.00 to<100.00	21.8	74.82	236	15.91	13.0	5.5
<b>100.00 (Default)</b>	28.3	100.00	301	15.66	44.9	2.3
<b>Total</b>	<b>10,324.7</b>	<b>0.82</b>	<b>85,024</b>	<b>22.48</b>	<b>2,108.5</b>	<b>28.4</b>

\*PD's displayed above relate to the incumbent IRB model whereas the RWEA includes the impact of the PMA.

# IRB Approach Overview

The Retail IRB ratings system is used to assess the credit risk exposure of the Society and the level of regulatory capital to be held.

The models are built using:

- PD – the probability of an obligor defaulting in the next 12 months;
- EAD – an estimate of the outstanding balance if the customer does default; and
- LGD – an estimate of the outstanding balance not recovered and the costs associated with that recovery process.

Expected loss for the next 12 months is calculated using the models in previous table.

## IRB Approach Overview (continued)

The PD model predicts the likelihood of a mortgage defaulting within the next 12 months. Default is defined as being six or more months in arrears, or earlier if the borrower displays one or more indicators that they are unlikely to make repayments. The probability of default is calculated using a combination of the credit score obtained at the point of application, the behavioural score and the arrears status of the mortgage. This approach allows for grade migration to occur as account performance is influenced by the economic cycle. The PD model for retail mortgages uses a hybrid rating system that combines Point in Time grade distributions with conservatively assessed long run default probabilities that are mapped for each grade.

The LGD and EAD models calculate 'best estimate' and 'downturn' values. The downturn values are used when calculating the Pillar 1 capital requirement.

The LGD model uses estimates of the ratio of the outstanding balance to estimated property value, the current point in the house price cycle relative to the trough of the house price cycle, arrears management and recovery costs and the time that would be taken to obtain possession and realise the value of the property through sale to predict the loss on sale.

The EAD value conservatively adjusts the current balance to allow for additional interest and fees that would be added to the balance prior to default. Where applicable it also includes any committed exposures, such as undrawn mortgage approvals.

The PD and LGD models were built using both internal data relating to the borrower and property, and external data obtained from credit reference agencies. Data from the 1990s was used to ensure that an appropriate long run average default rate could be calculated, and that LGDs were adjusted for downturn conditions, such as those seen in the recession of the early 1990s.

Monitoring of the IRB rating system and its component models continues to show it to be powerful and appropriately conservative. The performance of the PD model is assessed by measuring the power of the model (using the GINI coefficient) and comparing the number of predicted defaults with the number of actual defaults over a 12 month period. The PD model continues to have a GINI value that meets the Society's internal monitoring standards and conservatively over-predicts the volume of defaults.

As at December 2023, the default rate prediction from the previous year, which is derived from the Retail PD model, was approximately 70% higher than the actual default rate experienced during 2023. This indicates that at an aggregate level the PD model is appropriately conservative. In 2023, six repossessed properties were sold (2022: 15; 2021: 3). All but one of these was a residential, owner occupied property. The LGD model remains conservative, with no losses incurred on any of the six possession and sale events.

With such a low volume of sales, an assessment of the performance of the LGD model is made acknowledging that there may be individual exceptional cases where the level of loss could not be reasonably predicted using a statistical modelling approach. With this in mind, actual loss experience has been favourable compared with the predictions of the LGD model.

The models are also used within the Society for the following purposes:

- Pricing of credit risk into mortgage products
- Providing a risk assessment, or credit score, of the mortgage applicants which is used in the decision-making process
- Eligibility for additional borrowing for existing customers
- Capital planning
- Monitoring of IFRS 9 provision methodology

The following table shows the Society's back testing of PD based on the exposure to first charge retail mortgages under IRB at 31 December 2023:

**IRB approach – Back-testing of PD per exposure class (fixed PD scale) (UK CR9)**

PD Bands %	Number of Obligors Dec-2023 #	Number of Obligors Which Defaulted in the Year Dec-2023 #	Observed Average Default Rate Dec-2023 %	Exposures Weighted Average PD Dec-2023 %	Arithmetic Average PD Dec-2023 %	Average Historical Annual Default Rate <sup>2</sup> Dec-2023 %
<b>0.00 to&lt;0.15</b>	56,631	15	0.03	0.02	0.08	0.03
0.00 to<0.10	39,391	11	0.03	0.02	0.06	0.03
0.10 to<0.15	17,240	4	0.02	0.01	0.12	0.03
<b>0.15 to&lt;0.25</b>	9,855	9	0.09	0.09	0.19	0.07
<b>0.25 to&lt;0.50</b>	7,367	12	0.16	0.38	0.34	0.21
<b>0.50 to&lt;0.75</b>	1,605	9	0.56	0.49	0.61	0.41
<b>0.75 to&lt;2.50</b>	1,446	42	2.90	2.86	1.14	1.93
0.75 to<1.75	1,308	29	2.22	2.21	1.05	1.69
1.75 to<2.50	138	13	9.42	11.61	2.02	3.96
<b>2.50 to&lt;10.00</b>	606	53	8.75	9.23	7.31	6.84
2.50 to<5.00	170	15	8.82	8.36	3.41	4.93
5.00 to<10.00	436	38	8.72	9.56	8.83	7.52
<b>10.00 to&lt;100.00</b>	372	112	30.11	29.52	42.13	29.77
10.00 to<20.00	33	1	3.03	2.62	13.00	8.68
20.00 to<30.00	149	19	12.75	11.21	26.38	18.79
30.00 to<100.00	190	92	48.42	49.78	59.54	44.96
<b>100.00 (Default)</b>	259	259	100.00	100.00	100.00	100.00

**Notes and General Information on Exposures**

\* PD's displayed above relate to the incumbent IRB model whereas the RWEA includes the impact of the PMA.

^ The average historical annual default rate is calculated based on the realised monthly defaults (volume weighted), averaged over a measurement period. The measurement period is 5 years for the Society's exposures.

# Exposure class relates to retail exposures – non-SME secured by immovable property collateral.

**IRB model governance**

The MGC is the designated committee through which requests to implement any changes to the IRB rating system are formally submitted. Beneath MGC sits two sub committees, one of which the Credit Model Governance Committee (CMGC) endorses all credit models, this committee is chaired by Head of Prudential Risk.

The MGC receives regular management information on the performance of the individual components of the rating system and receives formal annual reviews of the accuracy, adequacy and use of the ratings system. Performance measures with trigger levels are set to ensure that any

amendments or updates are made when necessary.

Independent validation of the rating models is undertaken using a combination of MGC and appropriately skilled internal or external resource as appropriate. All model developments and material adjustments are subject to assessment against a comprehensive validation framework, which incorporates all relevant requirements from CRD IV. For each rating system, the outcome of the validation process is fully documented, and then challenged by the CMGC and then the MGC.



### IRB model governance (continued)

IRB models are operated by the Credit Risk function through an integrated capital calculation system. The system is regularly backed-up, and can be operated in an event that would require the full or partial operation of the Society's business continuity plans. The Society has a Change Control Policy which specifies how model changes are approved, type of approval required, and procedures describing how system changes are made.

### Retail Credit Risk Management

A series of specific limits and thresholds have been established and reflect the Society's view of and appetite for risk in relation to the residential mortgage portfolio. These limits are calibrated to ensure that expected or potential losses are restricted to levels consistent with the retail lending risk appetite.

The CRC receives regular reports on the performance of retail credit risk portfolios with further oversight provided by the BRC. The Society assesses affordability using a stressed, higher interest rate to protect the borrower from entering into a mortgage commitment which could prove unsustainable in a higher interest rate environment.

## 7.1.3 Secured Personal Lending Credit risk

The Society's subsidiary, Nemo Personal Finance Limited (Nemo), manages loans to individuals secured by way of a second charge over residential property. All customers therefore have an existing first mortgage, and a typical borrower requested finance to fund home improvements or to consolidate their debts. Depending on the borrower's status, loans were made available from £7,500 to £500,000 and were typically repayable over terms between three and twenty-five years.

During 2015 the Society reviewed its strategic options which resulted in the decision to cease new lending in Nemo. The Society continues to maintain and service its existing secured lending customers through a reshaped Nemo business.

### Nemo Credit Risk Management

The strategy for secured personal lending is to continue to manage the business prudently, but not take any new business onto the loan book. Management information is presented regularly to the Board Risk Committee. This ensures that the arrears management performance can be reviewed in the light of emerging trends.

Credit risk under Pillar 1 is calculated using the Standardised methodology for this portfolio, and risk weightings of 35% and 75% are applied to non-defaulted exposures, depending on the Balance to Value (BTV). At the point of application no Loan to Value (LTV) was greater than 100% although historically it had been possible for the capitalised Payment Protection Insurance (PPI) premium to raise the LTV above 100%.

Defaulted exposures attract a risk weighting of either 100% or 150% depending on the BTV and the level of provisions held. Adjustments to the exposure for Effective Interest Rate are treated as unsecured balances and risk weighted as such.

## 7.1.4 Commercial Lending Credit Risk

Commercial lending activity is split between lending to private sector landlords and property investors, registered social landlords, and funding for commercial projects.

The Society's commercial loan at 31 December 2023 portfolio comprises the following:

	Drawn commitments £m	Un-drawn commitments* £m	Total £m
Loans to Registered Social Landlords secured on residential property	211.9	17.5	229.4
Other loans secured on residential property	331.4	40.3	371.7
Of which: SMEs	271.4	39.0	310.4
Loans secured on commercial property	283.4	3.1	286.5
Of which: SMEs	224.8	2.8	227.6
Effective Interest Rate adjustment	(4.5)	-	(4.5)
	<b>822.2</b>	<b>60.9</b>	<b>883.1</b>

\*after the application of the appropriate credit conversion factors

### Commercial Credit Risk Management

Commercial lending risk appetite is regularly reviewed in the light of changing economic and market conditions and is also subject to a formal annual review. The Society remains cautious with regard to commercial lending which is undertaken on a prudent basis and management continues to adopt a strategy of maintaining long-term relationships. Commercial lending continues to operate within a framework of conservative credit criteria, principally focusing on the underlying income stream and debt servicing cover as well as property value. The Society continues to evaluate new opportunities to lend.

The Commercial Lending Division operates a relationship management approach. Each customer has a specific lending manager who is responsible for submitting credit applications for that customer (whether existing or new customer) and for managing the customer/lender relationship. Each lending manager is an experienced property lender with a strong track record gained in a traditional banking environment and/or within the division itself. Relationship managers are assigned based on experience/seniority and on size/complexity. Exceptions to this are connections in weak or defaulted slots where exposures are managed separately and also reviewed by Higher Risk Exposure Committee which is chaired by the Chief Executive Officer (CEO).

Commercial lending exposures are underwritten against comprehensive and well established criteria which are articulated in the division's Credit Risk Policy Statement. A risk grading framework has been developed, and the entire portfolio is risk graded. Additionally, with the exception of loans to Registered Social Housing Landlords, each exposure is assigned a slot which will determine its risk weighting and in turn support underwriting decisions/sanctioning authorities alongside pricing requirements and wider portfolio management design principles. Every slot and risk grade is reviewed at least annually in line with the principles of good credit husbandry and IRB requirements.

The credit risk capital requirement for the Society's commercial lending under Pillar 1 is determined by reference to the IRB methodology and uses a Specialised Lending Exposures approach. Loans are graded and slotted according to risk and assigned a prescribed risk weight and expected loss, based on the regulatory slot as illustrated in the table below.



## Specialised lending: Project finance (Slotting approach) (UK CR10.1)

Slot	Remaining Maturing	Exposure at Default	Risk Weight	Risk Weight Exposure Amount	Expected Loss Amount
		£m	%	£m	£m
1 - Strong	<2.5 years	12.5	50	6.2	-
	>/=2.5 years	27.9	70	19.5	0.1
2 - Good	<2.5 years	219.1	70	153.4	0.9
	>/=2.5 years	294.1	90	264.7	2.3
3 - Satisfactory	<2.5 years	41.6	115	47.9	1.2
	>/=2.5 years	36.9	115	42.4	1.0
4 - Weak	<2.5 years	7.2	250	18.1	0.6
	>/=2.5 years	2.1	250	5.4	0.2
Non Defaulted Total	<2.5 years	280.4	77.4	225.6	2.7
	>/=2.5 years	361.0	91.0	332.0	3.6
5 - Default	<2.5 years	10.9	-	-	5.4
	>/=2.5 years	3.9	-	-	1.9
Totals	<2.5 years	291.3	73.3	225.6	8.1
	>/=2.5 years	364.9	87.6	332.0	5.5

Exposures to Registered Social Housing Landlords and the associated Effective Interest Rate adjustments are not included in the table above and remain on the standardised approach and are subject to a risk weighting of 35% due to low default nature and low BTV of this sector. Performance of the slotting process is monitored quarterly at the MGC.

### 7.1.5 Treasury Credit Risk

The Society has exposures to banks, building societies, multilateral entities and sovereign debt in its non-trading treasury portfolio. The Society does not operate a trading book. Exposures in the treasury portfolio are held for liquidity purposes or in the case of fair value exposures on derivatives, for hedging purposes.

The Society's policy is to carry sufficient liquid assets to meet both PRA requirements in terms of liquidity buffer-eligibility, and internal requirements calculated using stress testing and having regard to seasonality within the risk exposure caused by savings maturities and other planned business events.

## Treasury Credit Risk Management

Treasury credit risk arises from the investments held by the Society's Balance Sheet Management function in order to meet liquidity requirements and for general business purposes. The Balance Sheet Management function is responsible for managing this aspect of credit risk within operational limits as set out in the Society's Treasury Policy Statement.

Treasury counterparty exposures are reviewed on a weekly basis by the Finance Committee. Alongside this, counterparty ratings and any recent market intelligence are monitored to ensure that exposures remain consistent with the Society's risk appetite. Any changes to lines and limits are approved by Finance Committee within a framework prescribed by the Board.

The Society uses derivatives to reduce its exposure to market risk, for example interest rate and basis risk. The Society has been transacting all new eligible swaps via the London Clearing House (LCH) since 2014.

The Standardised Counterparty Credit Risk (SA-CCR) method is now used to determine exposures to institutions for derivatives which has led to an increase in required capital.

The risk weights are based on the lowest credit rating, obtained from Moody's and Fitch, of the counterparty to which the exposure is outstanding.

A significant proportion, 87.9% (2022: 89.2%), of the Society's derivative book is with the LCH at 31 December 2023. The derivative market conditions continued to be volatile throughout 2023. The collateral discussed below reflects that market volatility.

Basel III requires the Society to calculate a CVA charge to capital for derivatives that have not been centrally cleared. The Society continues to use the standardised approach to CVA and the impact of this can be seen in Sections 4.1 and 4.2. This charge to capital has increased due to a regulatory methodology change during 2023.

The following tables show the exposure values of the Society's Balance Sheet Management function calculated under the SA-CCR broken down by credit quality step as at 31 December 2023:

### Counterparty exposure by approach (UK CCR1)

Counterparty exposure by approach (UK CCR1)	Replacement Cost (RC) £m	Potential Future Exposure (PFE) £m	Δ Alpha Used	Exposure Value Pre-CRM £m	Exposure Value Post-CRM £m	Exposure Value £m	Risk Weighted Exposure Amount £m
SA-CCR	29.5	2.1	1.4	44.3	44.3	44.3	21.1
<b>Total</b>	<b>29.5</b>	<b>2.1</b>	<b>1.4</b>	<b>44.3</b>	<b>44.3</b>	<b>44.3</b>	<b>21.1</b>

### Central governments or central banks

Credit quality step	Risk weighting	Moody's ratings	Fitch's ratings	EAD Pre-CRM £m	EAD Post-CRM £m
1	0%	Aaa to Aa3	AAA to AA-	1,372.5	1,372.5

### Multilateral development banks

Credit quality step	Risk weighting	Moody's ratings	Fitch's ratings	EAD Pre-CRM £m	EAD Post-CRM £m
1	0%	Aaa to Aa3	AAA to AA-	24.1	24.1

## Financial Institutions

Credit quality step	Risk weighting	Moody's ratings	Fitch's ratings	EAD Pre-CRM £m	EAD Post-CRM £m
1	4%/20%	Aaa to Aa3	AAA to AA-	284.5	284.5
2	20%/50%	A1 to A3	A+ to A-	279.8	279.8
3	20%/50%	Baa1 to Baa3	BBB+ to BBB-	-	-
n/a	20%/50%	Unrated	Unrated	-	-
				564.3	564.3

Credit risk from derivatives and repurchase agreements are mitigated, where possible, through netting agreements whereby assets and liabilities with the same counterparty can be offset. All netting arrangements are legally documented through International Swaps and Derivatives Association (ISDA) and Global Master Repurchase Agreement (GMRA) with each counterparty.

This provides the contractual framework within which dealing activities across a full range of Over The Counter (OTC) products are conducted and contractually binds both parties to apply close-out netting across all outstanding transactions covered by an agreement if either party

defaults or other predetermined events occur.

Collateral is held or issued based on the net market valuation of the Society's derivatives with each counterparty. The collateral document is the ISDA or GMRA Credit Support Annex (CSA). The collateral document gives the Society the power to use any collateral placed with it in the event of the failure of the counterparty. The collateral obtained for derivatives is cash denominated in Sterling.

Below is a table which shows the composition of collateral for Counterparty Credit Risk (CCR) (UK CCR5) exposures as at 31 December 2023:

Collateral Type	Collateral Used in Derivatives Transactions			
	Fair Value of Collateral Received £m		Fair Value of Collateral Posted £m	
	Segregated	Unsegregated	Segregated	Unsegregated
Cash	-	198.5	108.0	82.9
<b>Total</b>	<b>-</b>	<b>198.5</b>	<b>108.0</b>	<b>82.9</b>

The table below shows the Society's Qualifying Central Counterparty (QCCP) exposures (UK CCR8):

	Exposure Value £m	Risk Weighted Exposure Amount £m
<b>Exposures to QCCPs (total)</b>		<b>0.1</b>
Exposures for trades at QCCPs (excluding initial margin); of which	2.1	0.1
(i) OTC Derivatives	2.1	0.1
Segregated initial margin	108.0	
Non-segregated initial margin	-	-
<b>Exposures to non-QCCPs (total)</b>		<b>21.1</b>
Exposures for trades at QCCPs (excluding initial margin); of which	42.1	21.1
(i) OTC Derivatives	42.1	42.1
Segregated initial margin	-	
Non-segregated initial margin	20.9	-

The Society currently has no exposures where a downgrade by the rating agencies would result in additional collateral becoming payable.

Below is a table which shows how the External Credit Assessment Institutions (ECAI) ratings mapped to risk weights for the Society's exposures.

Moody's	Fitch	Credit Quality Step	Risk Weights		
			Central governments and central banks	Institutions < 3 months maturity	Institutions > 3 months maturity
Aaa to Aa3	AAA to AA-	1	0%	20%	20%
A1 to A3	A+ to A-	2	20%	20%	50%
Baa1 to Baa3	BBB+ to BBB-	3	50%	20%	50%
Ba1 to Ba3	BB+ to BB-	4	100%	50%	100%
B1 to B3	B+ to B-	5	100%	50%	100%
Caa1 and below	CCC+ and below	6	150%	150%	150%

## 7.1.6 Impaired Exposures, Past Due Exposures and Impairment Provisions

For accounting purposes, past due exposures, impaired exposures and impairment provisions are defined as follows:

- Past due exposures - An exposure is past due when a counterparty has failed to make a payment when contractually due
- Impaired exposures - An exposure where the Society does not expect to collect all the contractual cash flows or to collect them when they are contractually due
- Impairment provisions - Impairment provisions are provisions held on the balance sheet as a result of the raising of a charge against profit for an expected loss. An impairment allowance is held against individual loans.

## Accounting Policy

Details of the Society's accounting policy in respect of impaired exposures and impairment provisions raised in respect of loans and receivables are provided in Note 1 of the 2023 Annual Report and Accounts.

During the year there were no recoveries that were recorded directly to the Society's income statement (2022: £0). These are recoveries made after loans have been written off.

## Analysis of Past Due Loans and Advances to Customers

The following table shows past due loan exposures and charges to the income statement for the year to 31 December 2023.

	Retail financial services	Secured personal lending	Commercial lending	Total
	£m	£m	£m	£m
Up to date	10,205.0	54.7	878.9	11,138.6
Past due:				
Up to 3 months	82.2	3.1	-	85.3
3 to 6 months	16.8	0.8	-	17.6
6 to 12 months	13.2	2.1	-	15.3
Over 12 months	7.2	2.2	-	9.4
Possessions	0.3	-	3.5	3.8
	119.7	8.3	3.5	131.4
<b>Total exposures</b>	<b>10,324.7</b>	<b>62.9</b>	<b>882.4</b>	<b>11,270.0</b>
Impairment provisions	20.4	2.6	11.6	34.6
(Charge)/release for the year	(5.2)	0.3	1.3	(3.6)

The amounts shown as past due represent the full amount of the loan outstanding, not just the amount that is past due. Past due loans, impaired loans and provisions are all UK based.

Details of the movement in impairment provisions for the year ended 31 December 2023 can be found in Note 19 of the 2023 Annual Report and Accounts.

## Debt securities

As at 31 December 2023, none of the treasury portfolio exposures were either past due or impaired (2022: none). There are no assets that would otherwise be past due or impaired whose terms have been renegotiated. In assessing impairment, the Society evaluates among other factors, the normal volatility in valuation, evidence of deterioration in the financial health of the investee, industry and sector performance and operational and financing cash flows. The Society holds £1.4m (2022: £1.6m) of provisions against its treasury exposures.

## Impairment Analysis by Geography

The Society has minimal exposures outside the UK as at 31 December 2023 as shown in section 7.1.1. The Balance Sheet Management 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.



## 7.1.7 Credit Risk Concentrations

Policy limits have also been set to enable the management of treasury credit risk concentration. These limits are actively monitored and relate to aggregate counterparty, country and asset class exposures.

For residential mortgages, LTV concentration limits are set within policy. Geographic concentration of risk is also monitored. The Society operates across the majority of the UK, but with a moderate concentration in Wales. As at 31 December 2023, approximately 31.3% of retail and secured personal lending loan exposures by account and 27.2% by value is concentrated in Wales.

By their nature, residential mortgages comprise a large number of intrinsically highly diversified small loans and have a low volatility of credit risk outcomes.

For commercial lending, exposure to each of the principal lending categories is monitored and limits are set restricting the aggregate exposure to any single counterparty or group of closely connected counterparties. Concentration of risk within the portfolio is monitored using indicators such as maturity profile, industry sector and geography. In terms of counterparty concentration, the largest single exposure to a commercial counterparty is 6.8% of gross balances in the commercial book.

## 7.1.8 Credit Risk Mitigation

The Society uses a wide range of techniques to reduce credit risk associated with its lending. The most basic of these is performing an assessment of the ability of the borrower to service the proposed level of borrowing without distress. However the risk is further mitigated by obtaining security for the funds advanced.

### Residential mortgages

Residential property is the Society's main source of collateral and means of mitigating credit risk inherent in its residential mortgage portfolio. All mortgage lending activities are supported by an appropriate form of valuation using an independent firm of valuers.

Collateral values are updated at each balance sheet date based on the best information publically available. Land Registry data is used in the Retail Financial Services portfolio with Nationwide Building Society data being used in the Secured Personal Lending portfolio. Both indices take account of the geographical location of the collateral. All residential property must be insured to cover property risks.

The value of residential property, conservatively adjusted for downturn economic conditions, is included within the calculation of LGD for IRB exposures.

### Commercial mortgages

Within the commercial portfolio the main source of collateral and means of mitigating credit risk is commercial and/or residential property. The latter reflects either the residential investment element of the portfolio or loans to Registered Social Housing Landlords. Collateral for the majority of the portfolio comprises first legal charges over freehold and long leasehold property but guarantees may also be taken as security. Guarantees and other off-balance sheet security are not used in the calculation of Pillar 1 capital requirements, therefore the exposure values before and after this type of credit risk mitigation are identical.

For property-based lending, supporting information such as professional valuations are an important tool to help determine the suitability of the property offered as security and, in the case of investment lending, generating the cash to cover interest and repay the advance. All valuations are undertaken by members of an approved panel of external independent valuers.

Hedging strategies are considered as part of the approval process and unless borrowers have chosen fixed rates, their exposure to interest rate movements must be deemed acceptable. Where the Society has itself entered into a fixed rate with a commercial borrower then any adverse mark to market positions are referenced in loan to value positions which are monitored on a regular basis.

Insurance requirements are always fully considered as part of the application process and the Society ensures that appropriate insurance is taken out to protect the property.

## Treasury

The credit limits for all counterparties are derived using a matrix based on external credit ratings. The limits are then calculated by reference to the general reserves of the Society, where the maximum exposure for each institution will be determined by the external rating. Typically all counterparties will have a minimum rating of Baa3/BBB-, for investments in mortgage backed securities the minimum rating is set at Aaa/AAA. Limits are set in accordance with CRR art. 395 and may not exceed 10% of the equity of the institution being considered for an exposure limit without prior approval of the Board. Subsidiaries of any institution will be assessed as a separate entity according to its own ratings. However, in those circumstances the overall exposure cannot exceed the aggregate Society limit.

## 7.2 Liquidity and funding risk

Liquidity risk is the risk that the Society has insufficient funds to meet its obligations as and when they fall due. Funding risk is the risk that funds are not available (or only available at an excessive cost) to allow a firm to re-finance its liquidity position or to allow it to grow in line with strategic plans. The objective of the Society's liquidity risk appetite is to maintain enough high quality liquid assets to allow it to survive a severe, but plausible stress over both a 30-day period, excluding the benefit of management actions, and a 90-day period, including the benefit of Board

agreed non-franchise damaging management actions, over the stress time frame and taking into account seasonality of cash flows.

The day-to-day management of liquidity and funding risk is the responsibility of the Society's Balance Sheet Management function, which oversees the Society's portfolio of liquid assets and wholesale funding facilities. The Finance Committee exercises control over levels of liquidity through the operation of strict liquidity policies and close monitoring, receiving weekly reports on current and projected liquidity positions.



Quantitative information of LCR (UK LIQ1)

	Total unweighted value (average) £m				Total weighted value (average) £m			
	Mar-2023	Jun-2023	Sept-2023	Dec-2023	Mar-2023	Jun-2023	Sept-2023	Dec-2023
<b>High- Quality Liquid</b>								
<b>Total HQLA</b>					<b>1,442.9</b>	<b>1,492.5</b>	<b>1,573.1</b>	<b>1,595.0</b>
<b>Cash – Outflows</b>								
Retail Deposits, of which:	6,730.2	6,767.6	6,901.3	7,059.3	449.3	459.3	481.8	505.0
Stable deposits	5,384.3	5,330.1	5,288.3	5,275.1	269.2	266.5	264.4	263.8
Less stable deposits	1,345.9	1,437.5	1,613.0	1,784.2	180.1	192.8	217.4	241.2
Unsecured wholesale funding	92.8	96.7	100.9	97.0	27.5	27.7	28.3	27.0
Non-operational deposits	92.8	96.7	100.9	97.0	27.5	27.7	28.3	27.0
Secured wholesale funding					4.6	4.6	4.6	4.6
Additional requirements	45.0	54.2	59.1	64.7	45.0	54.2	59.1	64.3
Outflows related to derivative exposures and collateral	45.0	54.2	59.1	64.7	45.0	54.2	59.1	64.3
Other contractual funding	16.8	19.3	21.7	25.0	11.2	13.7	16.1	18.9
Other contingent funding	665.1	744.4	826.2	866.1	177.3	201.4	225.0	238.8
<b>Total Cash Outflows</b>					<b>714.9</b>	<b>760.9</b>	<b>814.9</b>	<b>858.6</b>
<b>Cash - Inflows</b>								
Fully performing exposures	46.3	47.7	49.4	51.2	32.4	33.9	36.0	38.3
Other	26.1	30.2	34.7	40.8	26.1	30.2	34.7	40.8
<b>Total Cash Inflows</b>	<b>72.4</b>	<b>77.9</b>	<b>84.1</b>	<b>92.0</b>	<b>58.5</b>	<b>64.1</b>	<b>70.7</b>	<b>79.1</b>
Inflows subject to 75% cap	72.4	77.9	84.1	92.0	58.5	64.1	70.7	79.1
<b>Total Adjusted Value</b>								
Liquidity buffer					1,442.9	1,492.5	1,573.1	1,595.0
Total net cash outflows					656.4	696.8	744.2	779.5
<b>Liquidity coverage ratio</b>					<b>219.8%</b>	<b>215.6%</b>	<b>212.7%</b>	<b>204.9%</b>

## Notes and General Information on Liquidity Coverage Ratio

The LCR, which is calculated in accordance with the PRA Rulebook, measures the Society's ability to survive a 30 calendar-day combined institution specific and market wide stress event. This is calculated by dividing the Society's balance of High Quality Liquid Assets by the projected net cash outflow over the stress period. The key drivers of the Society's LCR are retail savings, mortgages where an offer has been made which has not yet been completed, wholesale funding maturities and potential collateral cash flows.

The Society's LCR disclosure (calculated as the average of month end observations over the previous 12 months) was 204.9% as at 31 December 2023.

The Society's average LCR has reduced over the course of the year, primarily driven by the uptick in projected cash outflows as a result of an increase in the size of the Society's retail deposit book that included growth via the digital channel on non-maturing products which carry an increased weighted average outflow rate and also the larger mortgage pipeline (mortgages where an offer has been made which has not yet completed) as the Society has increased the size of its balance sheet.

It should be noted that whilst the Society's average LCR has trended down during 2023 showing the Society is utilising excess liquidity, there remains considerable headroom over the regulatory minimum of 100%. The Society also incorporates LCR forecasting into its financial planning process to ensure that it exceeds the Board's risk appetite levels across the planning horizon.

The Society's funding is predominantly raised from Members' savings and deposit accounts, aligning with the Society's strategic purpose as a mutual and provides a typically stable funding source. This is supplemented by funds raised via the wholesale market, to support the Society's mortgage lending and provide diversity to its funding base. The Society's wholesale funding sources include deposits, medium term notes, drawings from the Term Funding Scheme with additional incentives for SMEs (TFSME), Residential Mortgage Backed Securities

(RMBS) and repos. The Society monitors and mitigates its concentration and re-financing risk as part of its internal liquidity and funding risk management.

The Society's liquidity buffer is principally comprised of Level 1 High Quality Liquid Assets, predominantly consisting of reserves held with the Bank of England, along with smaller balances of high quality supranational bonds and Level 1 eligible extremely high quality covered bonds. The Society also holds some Level 2b assets (high quality UK RMBS).

The Society uses derivatives to manage its interest rate risk only, and does not operate a trading book. Derivative cash flows captured in the LCR are principally related to potential collateral net outflows and are monitored via the Historical Look Back Approach (looking back at the maximum month on month collateral position movement over the previous 24 months to reflect the potential impact of an adverse market scenario on derivatives transactions), as well as recording due collateral and excess collateral as at the reporting dates.

The Board determines the level of liquid resources required to support the Society's strategy through undertaking an annual Internal Liquidity Adequacy Assessment Process (ILAAP) as part of the development of the Society's Corporate Plan. Stress tests consider a range of severe but plausible scenarios and their impact on the Society, particularly with respect to retail saving outflows. The Board approved the most recent ILAAP in June 2023.

As part of the supervisory assessment, the PRA proposed a £36.5m add-on under the current approach to Pillar 2 (Included because of the guidance; Other items in the LCR calculation that are not captured in the LCR disclosure template but that the institution considers relevant for its liquidity profile).

The Society has a diverse funding base, with a strong track record of attracting and retaining retail funds through its range of retail product offerings, while maintaining a presence in the wholesale market, supported by external credit ratings.

## Net Stable Funding Ratio (UK LIQ2)

The Net Stable Funding Ratio (NSFR) is a key regulatory metric to monitor the funding profile of a firm over a longer term horizon and to ensure sufficient coverage of its asset base. The ratio compares PBS' available stable funding to its required stable funding.

Through close monitoring of NSFR, the reliance on short-term wholesale funding for balance sheet expansion is restricted and firms are incentivised to fund their activities with more stable sources of funding on an ongoing basis.

A stable funding profile reduces the likelihood that disruptions to the Society's funding sources will erode its liquidity position.

£m	Unweighted value by residual maturity				Weighted Value
	No maturity	< 6 months	6 months to < 1yr	≥ 1yr	
<b>Available stable funding (ASF) Items</b>					
<b>Capital items and instruments</b>	<b>696.5</b>	-	-	-	<b>696.5</b>
Own funds	696.5	-	-	-	696.5
<b>Retail deposits</b>		<b>5,418.5</b>	<b>1,434.8</b>	<b>1,828.7</b>	<b>8,256.4</b>
Stable deposits		4,038.3	1,156.5	1,633.6	6,568.7
Less stable deposits		1,380.2	278.3	195.1	1,687.7
<b>Wholesale funding:</b>		378.1	295.9	1,463.1	1,698.1
Other wholesale funding		378.1	295.9	1,463.1	1,698.1
<b>Other liabilities:</b>	<b>-</b>	<b>354.0</b>	<b>-</b>	<b>12.1</b>	<b>12.1</b>
<b>Total available stable funding (ASF)</b>					<b>10,663.1</b>

£m	Unweighted value by residual maturity				Weighted Value
	No maturity	< 6 months	6 months to < 1yr	≥ 1yr	
<b>Required stable funding (RSF) Items</b>					
Total high-quality liquid assets (HQLA)					<b>29.6</b>
Deposits held at other financial institutions for operational purposes		<b>95.5</b>	-	-	<b>47.8</b>
Performing loans and securities:		<b>103.6</b>	<b>98.2</b>	<b>9,571.5</b>	<b>7,333.5</b>
<i>Performing residential mortgages, of which:</i>		103.6	98.2	9,571.5	7,333.5
<i>With a risk weight of less than or equal to 35% under the Basel II Standardised Approach for credit risk</i>		44.0	42.9	8,711.1	6,531.7
Other assets:		(13.7)	-	67.9	66.6
<i>Assets posted as initial margin for derivative contracts and contributions to default funds of CCPs</i>		16.9			14.4
<i>NSFR derivative assets</i>		0.1			0.1
<i>NSFR derivative liabilities before deduction of variation margin posted</i>		0.9			0.0
<i>All other assets not included in the above categories</i>		(31.7)	-	67.9	52.1
Off-balance sheet items		367.9	51.2	-	291.9
<b>Total RSF</b>					<b>7,769.4</b>
<b>Net Stable Funding Ratio (%)</b>					<b>137.3</b>

### Notes on Net Stable Funding Ratio

NSFR is not a volatile metric as the Society's balance sheet is largely comprised of retail savings and long dated secured wholesale funding retail mortgages. There have been no significant movements across the year. The largest intra-period movement (3%) was in Q2 when excess liquidity was utilised to fund mortgage growth.

The Society's NSFR disclosure (calculated as the average of quarterly observations over the previous 12 months) was 137.3%, the as at 31 December 2023 NSFR was 134.6%.

The Society currently holds no interdependent assets or liabilities.



## 7.3 Business Risk

Business risk is the risk arising from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, competitive, geographical, regulatory or other factors.

The Society considers strategic risk, the risk to the delivery of the Society's Corporate Plan, to be the principal business risk. Whilst all business areas are responsible for managing their own risks, management of strategic risk is primarily the responsibility of the Board and the Board Risk Committee whose remit encompasses all risk categories on a Society wide basis.

The Board maintains a robust strategic planning process which is subject to oversight by the risk function and supported by a capital and liquidity stress testing programme. Consolidated business performance and risk reporting are provided to the Board and senior risk committees whose remit encompasses the oversight of all risk categories and an assessment of emerging strategic risks.

## 7.4 Market Risk

Market risk is the risk that the value of, or income arising from the Society's assets and liabilities is adversely impacted as a result of changes in market prices, the principal elements being interest rate risk, including the use of derivatives.

The Society's Balance Sheet Management function is responsible for managing the Society's exposure to all aspects of market risk within the operational limits set out in the Society's Treasury Policy statement. Oversight is provided by the Second Line Financial Risk Function, ERC and BRC which approves the interest rate risk policy and receives regular reports on all aspects of market risk. Reporting lines and terms of reference are set out by the Board which also receives monthly reports from the Chief Financial Officer covering the most material issues considered by the Finance Committee.

### Interest Rate Risk

Interest rate risk is the risk that the value of, or income arising from, Principality's assets and liabilities changes as a result of movement in market prices. As interest rate risk can manifest itself as both an impact on the Society's Economic Value and/or the Society's earnings (or Net Interest Income - NII), both metrics are considered when assessing the level of Interest Rate Risk in the Banking Book (IRRBB). It should be noted that Principality does not operate a trading book. Principality's interest rate risk arises primarily from the provision of fixed rate lending and savings products. The various interest rate features and maturity profiles of these products create interest rate risk exposures due to the imperfect matching of interest rates between different financial instruments.

The Board are responsible for setting risk appetite with the Finance Committee then responsible for monitoring and managing interest rate risk within appetite in line with the Society's interest rate view.

IRRBB is subject to the "Three Lines of Defence" model with oversight undertaken by Second Line and assurance provided by Internal Audit.

### The Key interest rate risks to which Principality Building Society is exposed are:

- Interest Rate Risk
- Basis Risk
- Optionality Risk (predominantly pipeline and prepayment risk)
- Structural Risk

### Interest Rate Risk is specifically managed and mitigated through a combination of:

- Monitoring and reporting risk exposures
- Matching or offsetting exposures
- Appropriate use of derivatives
- Design of appropriate product features, such as early repayment charges

Interest Rate Risk is measured using a combination of value and earnings based measures. Economic Value of Equity (EVE) and Net Interest Income (NII) sensitivities are both calculated monthly and subsequently presented to the Executive Risk Committee.

EV (Economic Value which is the same as EVE however it also includes the Society's retained earnings) sensitivity is measured on a daily basis through the use of an IRRM system, and is presented to Finance Committee each week as well as the Executive Risk Committee on a monthly basis.

A number of other limits, triggers and Early Warning Indicators (EWIs) are also monitored regularly, some daily, to ensure interest rate risk is appropriately managed at all times.

### The Society's EVE and NII sensitivities are calculated in accordance with the PRA's regulatory requirements. EVE is calculated against the six prescribed interest rate shocks:

- Parallel Shock Up (250 basis points)
- Parallel Shock Down (250 basis points)
- Steepener
- Flattener
- Short Rate Up
- Short Rate Down.

Additional EV scenarios are also run internally to calibrate against risk appetite.

NII, for the purposes of template UK IRRBB1, is calculated against a Parallel Shock Up (250 basis points), and a Parallel Shock Down (250 basis points). As with EV, additional scenarios are run internally for NII exploring other non-linear sensitivities.

**The key assumptions used in calculating EVE sensitivity as shown in template UK IRRBB1 are as follows:**

- Rate sensitive assets and liabilities are grouped into time buckets based on their next repricing date.
- The notional value of swaps is included in the EVE calculation, as well as the actual interest cash flows.
- Prepayment assumptions are made for Retail fixed rate mortgages, but not Commercial.
- Repayment is calculated first, and then prepayment (in that order)
- A conversion percentage is applied to all retail mortgage pipeline
- The balance sheet is taken as at the report date and is then allowed to run off as the various assets and liabilities mature.
- The sensitivity represents the difference between the Base Scenario (discounted using the present day yield curve) and the Stressed Scenarios (discounted using the relevant stressed yield curve).
- All non-parallel scenarios are modelled assuming the EBA regulatory floor (i.e. a glide path from – 100 basis points at the Overnight grid point increasing on a straight line basis to reach 0% at the 20 year grid point). Both parallel shock scenarios assume no floor exists.
- Non-maturing deposits (NMDs) are assumed to reprice in one month.
- Principality’s reserves are excluded from the calculation.

**The key assumptions used in calculating NII sensitivity as per the template UK IRRBB1 are as follows:**

- Calculated based on the 12 month period starting 31st December 2023.

- Expected cash flows (including commercial margins and other spread components) arising from all interest rate-sensitive assets, liabilities and off-balance sheet items are included.
- Computed assuming a static, constant balance sheet, where maturing or repricing cash flows are replaced by new cash flows with identical features with regards to amount, repricing period and spread components.
- Contractually floored products e.g. Discount mortgages, are modelled to honour existing terms and conditions.
- Pipeline figures and Forward Starting Swaps are excluded from the calculation.

The NII sensitivity presented in the template UK IRRBB1 is calculated with the assumption that savings rates could become negative in the 250 basis point parallel shock down. This is not the case in internal NII modelling where a more plausible assumption is made meaning that customer rates do not reduce below zero even if market rates do.

Internal modelling for economic value leans more towards EV than EVE meaning that reserves are included unlike the disclosure in template UK IRRBB1.

Interest rate risk is hedged through a combination of natural hedging (matching assets against pre-existing liabilities of the same volume and duration) where possible, and then through the appropriate use of derivatives. Principality’s reserves are also assigned a duration allowing them to be used to hedge fixed rate mortgages.

Any derivatives transacted with external counterparties in relation to hedging fixed rate assets and liabilities are recognised through the application of Fair Value Hedge Accounting in accordance with IAS 39. Further details can be found in note 16 of the 2023 Annual Report and Accounts.

The following table shows changes in the IRRBB following shock scenarios (UK IRBB1) as at 31 December 2023:

	$\Delta$ EVE	$\Delta$ EVE	$\Delta$ NII	$\Delta$ NII	Tier 1 Capital	Tier 1 Capital
	Dec-2023	Dec-2022	Dec-2023	Dec-2022*	Dec-2023	Dec-2022
Parallel shock up	(24.0)	(16.3)	19.0	19.8		
Parallel shock down	27.1	18.7	(18.8)	(13.2)		
Steeper shock	(1.8)	(3.8)				
Flattener shock	(2.7)	(0.7)				
Short rates shock up	(10.5)	(9.6)				
Short rates shock down	7.1	6.8				
Maximum	27.1	18.7	19.0	19.8		
Tier 1 Capital					688.1	658.2

\*2022 values have been restated due to a change in judgement around the inclusion of forward starting swaps.

## Notes and General Information on IRRBB

EVE Sensitivity – The worst case result without management actions of the 6 shocks modelled comes from the 250 basis points parallel shock up – (£24.0m). This means that if interest rates were to increase overnight by 250 basis points and then stay at that level, Principality’s balance sheet would decrease in value by £24.0m. It represents a Supervisory Outlier Test result of 3.5% which is well within the 15% regulatory threshold. If the Society’s reserves were to be included in the calculation then (£24.0m) would become £6.2m indicating the significance of Principality’s use of its reserves for hedging purposes.

NII Sensitivity – The worst case result without management actions of the 6 shocks run from an NII point of view is the 250 basis points parallel shock down – (£18.8m). This shows that over a 12 month period, Principality could lose £18.8m of its NII. The equivalent under a 250 basis point parallel shock up results in a £19.0m improvement in NII.

### Use of derivatives

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

The principal derivatives currently used by the Society are interest rate exchange contracts, commonly known as interest rate swaps.

The principal activities undertaken by the Society relate to fixed rate savings products, fixed rate funding, fixed rate mortgage lending and fixed rate investments. These activities are sensitive to changes in interest rates. The related interest rate risks associated with these activities are managed by an interest rate swap type of derivative.

The Society uses derivatives in accordance with the terms of 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.

### Pension Obligation Risk

The Society has funding obligations for a defined benefit scheme which is closed to new entrants and further accrual. It was closed to future accrual on 31 July 2010. Pension obligation risk is the risk that the value of the Fund’s assets, together with ongoing employer contributions, will be insufficient to cover the projected obligations of the Fund over time. The return on assets, which includes cash 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.

Scheme management consists of a Board of Trustees, comprising four individuals, three of which are Society Nominated Trustees and one Member Nominated Trustee. The power of appointment and removal of the Trustees is vested in the Society in accordance with the Trust Deed.

In September 2012 the Society concluded a ‘buy-in’ arrangement in order to reduce future uncertainty regarding ongoing costs and liabilities associated with the scheme. In September 2023 a second buy-in with LGAS was transacted which covered all remaining members of the pension scheme. The buy-in was funded utilising the existing scheme assets and additional contributions from the Society totalling £13.5m.

The annuity policy excludes the impact of GMP equalisation, additional contributions of £1.5m are expected to be made by the Society during 2024 and 2025 in respect of GMP equalisation.

Further information on the Society’s pension schemes can be found in note 12 to the 2023 Annual Report and Accounts.

### Foreign 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 Society’s non-sterling funding.

The Society has no exposure to foreign exchange rate fluctuations and therefore currency risk is not material for the Society.

## 7.5 Conduct Risk

Conduct risk is the risk of treating customers unfairly resulting in the delivery of inappropriate outcomes. The Board has no appetite for inappropriate customer outcomes arising at any stage and focuses efforts in those areas where conduct risk is most likely to occur, ensuring those risks are mitigated as effectively as possible.

The sustainability of the Society’s business model and achievement of its longer-term strategy are dependent upon the consistent and fair treatment of Members and customers. The Society has always been committed to ensuring that Members and customers are treated fairly. The Financial Conduct Authority’s policy statement proposing a new ‘Consumer Duty’ came into force on 31 July 2023 and aims to raise standards across the financial services sector,

requiring firms to demonstrate that their culture, activities and behaviours deliver good outcomes.

The Society’s Conduct Strategy Framework for managing conduct risk broadens and develops its conduct picture, ensuring that it continues to remain relevant whilst highlighting the direct link to its organisational strategy and reflecting a greater emphasis on its culture as a mutual organisation. The Conduct Strategy is designed to identify, manage and measure conduct risk by reference to four categories: Customer, Culture, Colleague and Regulatory Conduct. Regular feedback from members and customers is also obtained.

Further details of conduct risk governance are included in the Risk Overview of the 2023 Annual Report and Accounts.

## 7.6 Solvency Risk

This is the risk that the Society does not maintain sufficient capital resources in excess of minimum regulatory requirements.

Capital is held to protect depositors, by ensuring that there will be sufficient assets to repay liabilities even in the event of unexpected losses. When assessing the adequacy of available capital, the Board considers the material and inherent risks to which we are exposed and the need for capital to be available to support the growth of the business. Solvency risk is subject to regular review and is managed within the risk appetite set by the Board.

## 7.7 Legal and Regulatory Risk

This is the risk that the Society does not comply with legislation and regulation. The Society has developed processes to monitor and record legal and regulatory pronouncements and notifications. These are assessed by the relevant internal subject-matter experts and, where appropriate, action plans are developed to ensure compliance by the required deadline. The register of pronouncements and notifications is reviewed on a regular basis to ensure that a coordinated approach is adopted to ensure compliance.

The Society manages implementation of regulatory changes through dedicated prioritised programmes that are closely monitored by the Board and Board Risk Committee to ensure appropriate compliance. Further details of legal and regulatory risk governance are included in the Risk Overview of the 2023 Annual Report and Accounts.

## 7.8 Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal processes or systems, human error or external events.

The Society's Enterprise Risk Management Policy sets out the framework and strategy to identify, assess and manage all risks, including operational, with senior management having responsibility for understanding the nature and extent of the impacts on each business area and for embedding the appropriate controls to mitigate those risks. The framework is reviewed periodically to take account of changes in business profile, new technology and product development and the external operating environment.

Risk appetite is captured for all principal risk categories, including Operational Risk, and for each secondary operational risk category. Each risk on the register is assessed using a 'Probability/Impact' matrix which is used

to capture the potential risk to the Society, quantifying financial and other impacts including customer, regulatory and reputational, before and after taking into account the effectiveness of management controls, and other forms of mitigation.

The risk registers are subject to regular review by each risk owner and the Society's Risk function with key management information reported to the Board quarterly. For individual risks which are deemed unacceptable, remedial action is taken (where such action falls within the Society's control) which includes introducing or enhancing the operational controls and/or risk mitigations related to the individual risk, or taking appropriate action to eliminate the risk altogether.

The risk assessment framework is subject to review by the Internal Audit function. The focus and prioritisation of the Internal Audit annual programme takes into account assessment of the Society's risk profile and control environment.

The initial challenge to the risk owner's assessment and the effectiveness of management controls is provided by specialist teams forming part of the Society's 'Second Line of Defence', taking into consideration an assessment of any changes to the internal/external operating environment, the performance of key risk indicators and reported operational risk events. Additional oversight is provided by the Operational Risk Committee (ORC), Executive Risk Committee (ERC) and Board Risk Committee (BRC), particularly in relation to the Society key risk report which is submitted to the Board each quarter.

Operational risk events, including those which generate losses, are recorded as they arise and reported to the Risk function by the business. All operational losses and 'near misses' are reported to and reviewed by ORC on a quarterly basis to identify potential trends and to determine whether any review of internal procedures or controls is required in order to mitigate against any potential recurring operational losses. Additional oversight is achieved through management information reported to ERC and BRC on a quarterly basis.

Under the Basel Capital Accord for the standardised approach to operational risk, gross income is regarded as a proxy for the operational risk exposure within each business line. The capital charge for operational risk is calculated separately, based upon gross income over the preceding three years.

### Operational risk own funds requirements and risk-weighted exposure amounts (UK OR1)

Banking activities (£m)	Relevant indicator			Own Funds requirements	Risk Weighted Exposure Amount
	Year 3	Year 2	Last Year		
Standardised Approach*	132.1	158.8	183.6	19.6	244.9

\*The Risk weight for Retail Banking is 12% and for Commercial banking is 15%.

Further details of operational risk governance are included in the Risk Overview of the 2023 Annual Report and Accounts.

# 8. Securitisation

## 8.1 Retained Securitisation Positions

The Society currently has four Residential Mortgage Backed Security (RMBS) issuances in place as a means of raising wholesale funding. In September 2023, Friary No. 8 Plc was issued. The RMBS issuances involve the formation of special purpose entities (SPEs), currently Friary No. 5 plc, Friary No. 6 plc, Friary No. 7 plc and Friary No. 8 plc, which have purchased beneficial interests in separate portfolios of residential mortgages that are funded by the issue of floating rate mortgage backed securities (the Notes). Friary No. 6, 7 and 8 follow the simple, transparent and standardised securitisation methodology with no re-securitisation.

The Notes have been issued by Friary No. 5 plc, Friary No. 6, Friary No. 7 plc and Friary No. 8 plc to external counterparties and/or to the Society, either internally for the purposes of creating collateral to be used for funding, or externally and directly for cash via the sale of the Notes to investors outside the Society. The Society is both originator and servicer for each of the issuances. Other roles fulfilled by the Society are fully described in the Friary No. 5 plc, Friary No. 6 plc, Friary No. 7 and Friary No. 8 plc base prospectuses, copies of which can be found at [www.euroabs.com](http://www.euroabs.com).

The equity of Friary No. 5 plc, Friary No. 6 plc, Friary No. 7 plc and Friary No. 8 plc is not owned by the Society. However, to comply with the Building Societies Act 1986 (International Accounting Standard and Other Accounting Amendments) Order 2004 and IFRS 10 consolidated financial statements, all companies are consolidated into the Society financial statements.

The Notes are serviceable firstly from cash flows generated by the mortgage assets and thereafter from the proceeds of the

subordinated loans. The Society receives the excess spread on the transactions as deferred consideration, after Friary No. 5 plc, Friary No. 6 plc, Friary No. 7 plc and Friary No. 8 plc have met their liabilities.

As at 31 December 2023, £185.2m (2022: £225.4m) of mortgages issued by the Society had been transferred to Friary No. 5 plc which remains 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 was £190.4m (2022: £240.2m), with £237.4m (2022: £223.7m) retained by the Society. £190.4m (2022: £193.1m) of the self-issued securities retained by the Society in relation to Friary No. 5 plc are capable of repo financing. As at 31 December 2023, 0.77% (2022: 0.53%) of the mortgages transferred to Friary No. 5 plc were greater than 2 months in arrears.

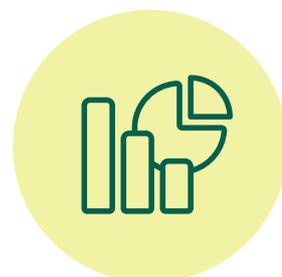
As at 31 December 2023, £163.2m (2022: £194.8m) of mortgages issued by the Society had been transferred to Friary No. 6 plc which remains on the statement of financial position of the Society as it retains the risks and rewards. These assets are treated as encumbered. The amortised value of the bond was £168.4m (2022: £207.7m), with £30.4m (2022: £30.4m) retained by the Society. None of the self-issued securities retained by the Society in relation to Friary No. 6 plc are capable of repo financing. As at 31 December 2023, 0.57% (2022: 0.34%) of the mortgages transferred to Friary No. 6 plc were greater than 2 months in arrears.

As at 31 December 2023, £389.8m (2022: £452.9m) of mortgages issued by the Society had been transferred to Friary No. 7 plc which remains 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 was £406.0m (2022: £489.1m), with £120.6m (2022: £139.1m) retained by the Society. £81.5m (2022: £100m) of the self-issued securities retained by the Society in relation to Friary No. 7 plc are capable of repo financing. As at 31 December 2023, 0.15% (2022: 0.08%) of the mortgages transferred to Friary No. 7 plc were greater than 2 months in arrears.

As at 31 December 2023, £566.5m of mortgages issued by the Society had been transferred to Friary No. 8 plc which remains 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 was £406.0m with £97.8m retained by the Society. £50.0m of the self-issued securities retained by the Society in relation to Friary No. 8 plc are capable of repo financing. As at 31 December 2023, 0.04% of the mortgages transferred to Friary No. 8 plc were greater than 2 months in arrears.

As there is not considered to be a transfer of significant credit risk, the Society does not calculate risk weighted exposure amounts for any positions it holds in the securitisations which continue to be calculated in line with CRD IV requirements. Securitisation positions held by the Society are valued at fair value by note class. There have been no changes to the methods and key assumptions used to value the securitisation positions held.



The balances of assets subject to securitisation and notes in issue as at 31 December 2023 are as follows:

Securitisation Company	Type	Date of Securitisation	Dec-2023 Notes in Issue £m	Dec-2023 Balance of Assets £m	Dec-2022 Notes in Issue £m	Dec-2022 Balance of Assets £m
Friary No.5 plc	Residential mortgage	14 March 2019	190.4	185.2	240.2	225.4
Friary No.6 plc	Residential mortgage	28 November 2019	168.4	163.2	207.7	194.8
Friary No.7 plc	Residential mortgage	22 September 2022	406.0	389.8	489.1	452.9
Friary No.8 plc	Residential mortgage	14 September 2023	597.8	566.5	-	-

Note Class	Dec-2023 Note Balance £m	Dec-2022 Note Balance £m
Friary No.5 plc		
A	143.3	193.1
B	47.1	47.1
<b>Total</b>	<b>190.4</b>	<b>240.2</b>
Friary No.6 plc		
A	138.0	177.3
B	30.4	30.4
<b>Total</b>	<b>168.4</b>	<b>207.7</b>
Friary No.7 plc		
A	366.9	450.0
B	39.1	39.1
<b>Total</b>	<b>406.0</b>	<b>489.1</b>
Friary No.8 plc		
A	550.0	-
B	47.8	-
<b>Total</b>	<b>597.8</b>	<b>-</b>

The Class B Notes in respect of the issuances were taken up by the Society at the time of the securitisation transaction and were effectively a credit enhancement.

Fitch and Moody's, both recognised ECAs, rated the Notes under the securitisation. The credit risk of the underlying mortgage pool is monitored by the Credit Risk Department. The market risk associated with the Notes is monitored by the Balance Sheet Management function. Interest rate swaps are in place to hedge the interest rate risk arising between the Notes and the underlying mortgage pool assets.

The Society participates in the Bank of England's Term Funding Scheme (TFSME). As at 31 December 2023 the Society had £900m (2022: £900m) under the TFSME scheme. The scheme allows the Society the ability to pledge mortgage assets with the Bank of England in return for cash.

The TFSME is repayable in increments starting in 2024 with final repayments in 2025. Asset encumbrance as at 31 December 2023 was 23.2% (2022: 22.0%) of total assets. Excluding encumbrance with the Bank of England asset encumbrance was 12.8% (2022: 10.6%). Further information on accounting policies for securitisations are included in note 1 to the 2023 Annual Report and Accounts.

## 8.2 Purchased Securitisation Positions

Since May 2012 the Society has selectively purchased senior tranches of positions in RMBS. The Society's total exposure to purchased securitisation positions at 31 December 2023 was £93.5m (2022: £10.8m) based on market values, with the exposures consisting entirely of residential mortgage-backed securities. Such purchased securitisation positions provide the Society with a diversified, capital-efficient source of investment income. Investments are undertaken within a clearly defined credit risk policy. The credit risk of the exposures underlying the purchased securitisation positions are monitored on a semi-annual basis for indications of impairment.

The aggregate fair values are calculated based on quoted market prices.

The purchased securitisation positions are all in the most senior tranches of the issued note classes of each securitisation and part of the Society's investment criteria is that that they must be AAA rated at issue. The credit ratings of the purchased notes are monitored for deterioration on an ongoing basis with any AAA notes being assigned a risk weighting of 20%. The following table shows the breakdown of the exposures by credit quality steps with indicative external credit assessment:

Credit quality step	Ratings			Exposures			
	Standard & Poor's	Moody's	Fitch	Dec-2023 Exposure Value £m	Dec-2023 Exposure Weighted Average RW %	Dec-2022 Exposure Value £m	Dec-2022 Exposure Weighted Average RW %
1	AAA	Aaa	AAA	93.5	20.0	10.8	20.0

The purchased securitisation positions are predominantly prime residential mortgage backed securities. These have all been originated and issued in the UK.



# 9. Non-Performing Loans

## 9.1 Credit quality of forbore exposures

In 2017, the European Council agreed an action plan to tackle non-performing loans (“NPL”) at national and European levels. This action plan included enhanced disclosures of non-performing loans. The guidelines specify the common content and uniform disclosure formats for the information on Non-performing exposures (“NPE”), forbore exposures and foreclosed assets that credit institutions should disclose. Proportionality has been embedded in the guidelines based on two criteria – the significance of the credit institution and the level of NPEs.

The table below provides an overview of the quality of the Society’s forbore exposures at 31 December 2023.

### Credit quality of forbore exposures (UK CQ1)

2023	Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forbore exposures £m
	Performing forbore £m	Non-performing forbore			On performing forbore exposures £m	On non-performing forbore exposures £m	
		£m	Of which defaulted	Of which impaired			
Loans and advances	172.2	29.7	16.4	27.1	(3.8)	(1.5)	196.6
Non-financial corporations	96.8	3.3	3.3	3.2	(2.1)	(0.3)	97.7
Households	75.4	26.4	13.1	23.9	(1.7)	(1.2)	98.9
<b>Total</b>	<b>172.2</b>	<b>29.7</b>	<b>16.4</b>	<b>27.1</b>	<b>(3.8)</b>	<b>(1.5)</b>	<b>196.6</b>

2022	Gross carrying amount/nominal amount of exposures with forbearance measures				Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions		Collateral received and financial guarantees received on forbore exposures £m
	Performing forbore £m	Non-performing forbore			On performing forbore exposures £m	On non-performing forbore exposures £m	
		£m	Of which defaulted	Of which impaired			
Loans and advances	158.7	21.5	10.2	20.1	(3.5)	(1.2)	175.5
Non-financial corporations	93.7	-	-	-	(1.7)	-	92.0
Households	65.0	21.5	10.2	20.1	(1.8)	(1.2)	83.5
<b>Total</b>	<b>158.7</b>	<b>21.5</b>	<b>10.2</b>	<b>20.1</b>	<b>(3.5)</b>	<b>(1.2)</b>	<b>175.5</b>

The tables below provide an overview of credit quality of non-performing exposures as at 31 December 2023. The table has been split into two tables, performing exposures and non-performing exposures for ease of reference.

### Credit quality of performing and non-performing exposures by past due days (UK CQ3 – Part 1)

2023	Gross carrying amount/nominal amount		
	Performing exposures £m	Not past due or past due ≤ 30 days £m	Past due > 30 days ≤ 90 days £m
Loans and advances	11,857.2	11,845.5	11.7
Central banks	1,373.7	1,373.7	-
Credit institutions	329.4	329.4	-
Other financial corporations	-	-	-
Non-financial corporations	509.4	509.4	-
Of which SMEs	485.6	485.6	-
Households	9,644.7	9,633.0	11.7
<b>Debt securities</b>	<b>317.6</b>	<b>317.6</b>	
Central banks	24.1	24.1	-
Other financial corporations	293.5	293.5	-
<b>Off-balance-sheet exposures</b>	<b>818.1</b>		
Other financial corporations	-		
Non-financial corporations	83.5		
Households	734.6		
<b>Total</b>	<b>12,992.9</b>	<b>12,163.1</b>	<b>11.7</b>

2022	Gross carrying amount/nominal amount		
	Performing exposures £m	Not past due or past due ≤ 30 days £m	Past due > 30 days ≤ 90 days £m
Loans and advances	10,891.5	10,881.6	9.9
Central banks	1,565.7	1,565.7	-
Credit institutions	277.1	277.1	-
Other financial corporations	-	-	-
Non-financial corporations	505.3	505.3	-
Of which SMEs	484.9	484.9	-
Households	8,543.4	8,533.5	9.9
<b>Debt securities</b>	<b>160.2</b>	<b>160.2</b>	-
Central banks	48.1	48.1	-
Other financial corporations	112.1	112.1	-
<b>Off-balance-sheet exposures</b>	<b>709.2</b>		
Other financial corporations	1.0		
Non-financial corporations	147.5		
Households	560.7		
<b>Total</b>	<b>11,760.9</b>	<b>11,041.8</b>	<b>9.9</b>

Credit quality of performing and non-performing exposures by past due days (UK CQ3 – Part 2)

2023	Gross carrying amount/nominal amount								
	Non-performing exposures £m	Unlikely to pay that are not past due or are past due ≤ 90 days £m	Past due > 90 days ≤ 180 days £m	Past due > 180 days ≤ 1 year £m	Past due > 1 year ≤ 2 years £m	Past due > 2 years ≤ 5 years £m	Past due > 5 years ≤ 7 years £m	Past due > 7 years £m	Of which defaulted £m
Loans and Advances	84.3	40.6	18.2	14.8	8.0	2.5	0.2	-	50.6
Non-Financial Corporations	14.0	14.0	-	-	-	-	-	-	14.0
Of which SMEs	14.0	14.0	-	-	-	-	-	-	14.0
Households	70.3	26.6	18.2	14.8	8.0	2.5	0.2	-	36.6
<b>Total</b>	<b>84.3</b>	<b>40.6</b>	<b>18.2</b>	<b>14.8</b>	<b>8.0</b>	<b>2.5</b>	<b>0.2</b>	<b>-</b>	<b>50.6</b>

2022	Gross carrying amount/nominal amount								
	Non-performing exposures £m	Unlikely to pay that are not past due or are past due ≤ 90 days £m	Past due > 90 days ≤ 180 days £m	Past due > 180 days ≤ 1 year £m	Past due > 1 year ≤ 2 years £m	Past due > 2 years ≤ 5 years £m	Past due > 5 years ≤ 7 years £m	Past due > 7 years £m	Of which defaulted £m
Loans and Advances	66.4	30.2	16.1	10.4	6.4	3.2	0.1	0.1	37.9
Non-Financial Corporations	6.2	6.2	-	-	-	-	-	-	6.2
Of which SMEs	6.2	6.2	-	-	-	-	-	-	6.2
Households	60.2	24.0	16.1	10.4	6.4	3.2	0.1	0.1	31.7
<b>Total</b>	<b>66.4</b>	<b>30.2</b>	<b>16.1</b>	<b>10.4</b>	<b>6.4</b>	<b>3.2</b>	<b>0.1</b>	<b>0.1</b>	<b>37.9</b>

The table below provides an overview of the credit quality of the Society's non-performing exposures and related impairments, provisions and valuation adjustments by portfolio and exposure class as at 31 December 2023. The table has been split into two, gross carrying amount and accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions.

#### Performing and non-performing exposures and related provisions (UK CR1 - Part 1)

2023	Gross carrying amount/nominal amount					
	Performing exposures			Non-performing exposures		
	£m	Of which stage 1	Of which stage 2	£m	Of which stage 2	Of which stage 3
<b>Loans and advances</b>	<b>10,156.4</b>	<b>8,241.9</b>	<b>1,914.5</b>	<b>82.0</b>	<b>-</b>	<b>82.0</b>
Other financial corporations	-	-	-	-	-	-
Non-financial corporations	509.3	436.9	72.4	14.0	-	14.0
Households	9,647.1	7,805.0	1,842.1	68.0	-	68.0
<b>Off-balance-sheet exposures</b>	<b>818.1</b>	<b>818.0</b>	<b>0.1</b>	<b>1.1</b>	<b>-</b>	<b>1.1</b>
Other financial corporations	-	-	-	-	-	-
Non-financial corporations	83.5	83.4	0.1	1.1	-	1.1
Households	734.6	734.6	-	-	-	-
<b>Total</b>	<b>10,974.5</b>	<b>9,059.9</b>	<b>1,914.6</b>	<b>83.1</b>	<b>-</b>	<b>83.1</b>

2022	Gross carrying amount/nominal amount					
	Performing exposures			Non-performing exposures		
	£m	Of which stage 1	Of which stage 2	£m	Of which stage 2	Of which stage 3
<b>Loans and advances</b>	<b>9,049.9</b>	<b>7,393.9</b>	<b>1,656.0</b>	<b>65.2</b>	<b>-</b>	<b>65.2</b>
Other financial corporations	-	-	-	-	-	-
Non-financial corporations	505.3	439.8	65.5	6.2	-	6.2
Households	8,544.6	6,954.1	1,590.5	59.0	-	59.0
Households	9,647.1	7,805.0	1,842.1	68.0	-	68.0
<b>Off-balance-sheet exposures</b>	<b>709.2</b>	<b>703.4</b>	<b>5.8</b>	<b>0.2</b>	<b>-</b>	<b>0.2</b>
Other financial corporations	1.0	1.0	-	-	-	-
Non-financial corporations	147.5	147.1	0.4	0.2	-	0.2
Households	560.7	555.3	5.4	-	-	-
<b>Total</b>	<b>9,759.1</b>	<b>8,097.3</b>	<b>1,661.8</b>	<b>65.4</b>	<b>-</b>	<b>65.4</b>

Performing and non-performing exposures and related provisions (UK CR1 – Part 2)

2023	Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions				On performing exposures	On non-performing exposures
	£m	Of which stage 1	Of which stage 2	£m	Of which stage 2	Of which stage 3		£m	£m
Loans and advances	(26.5)	(10.1)	(16.4)	(7.2)	-	(7.2)	-	-	-
Other financial corporations	-	-	-	-	-	-	-	-	-
Non-financial corporations	(5.3)	(2.9)	(2.4)	(2.6)	-	(2.6)	-	-	-
Households	(21.2)	(7.2)	(14.0)	(4.6)	-	(4.6)	-	-	-
<b>Total</b>	<b>(26.5)</b>	<b>(10.1)</b>	<b>(16.4)</b>	<b>(7.2)</b>	<b>-</b>	<b>(7.2)</b>	<b>-</b>	<b>-</b>	<b>-</b>

2022	Accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions						Accumulated partial write-off	Collateral and financial guarantees received	
	Performing exposures – accumulated impairment and provisions			Non-performing exposures – accumulated impairment, accumulated negative changes in fair value due to credit risk and provisions				On performing exposures	On non-performing exposures
	£m	Of which stage 1	Of which stage 2	£m	Of which stage 2	Of which stage 3		£m	£m
Loans and advances	(24.5)	(13.5)	(11.0)	(6.1)	-	(6.1)	-	-	-
Other financial corporations	-	-	-	-	-	-	-	-	-
Non-financial corporations	(7.6)	(6.4)	(1.2)	(1.5)	-	(1.5)	-	-	-
Households	(16.9)	(7.1)	(9.8)	(4.6)	-	(4.6)	-	-	-
<b>Total</b>	<b>(24.5)</b>	<b>(13.5)</b>	<b>(11.0)</b>	<b>(6.1)</b>	<b>-</b>	<b>(6.1)</b>	<b>-</b>	<b>-</b>	<b>-</b>

The table below shows the credit quality of loans and advances to non-financial corporations by industry as at 31 December 2023.

### Credit quality of loans and advances to non-financial corporations by industry (UK CQ5)

2023	Gross carrying amount				Accumulated Impairment
	£m	Of which non-performing		Of which loans and advances subject to impairment	
		£m	Of which defaulted		
	£m	£m	£m	£m	£m
Construction	47.6	3.5	3.5	47.6	(2.1)
Wholesale and retail trade	1.4	-	-	1.4	-
Real estate activities	458.0	10.6	10.6	458.0	(4.9)
Administrative and support service activities	14.8	-	-	14.8	(0.9)
Education	0.2	-	-	0.2	-
Other services	1.4	-	-	1.4	-
<b>Total</b>	<b>523.4</b>	<b>14.1</b>	<b>14.1</b>	<b>523.4</b>	<b>(7.9)</b>

2022	Gross carrying amount				Accumulated Impairment
	£m	Of which non-performing		Of which loans and advances subject to impairment	
		£m	Of which defaulted		
	£m	£m	£m	£m	£m
Construction	32.0	3.0	3.0	32.0	(1.4)
Wholesale and retail trade	1.5	-	-	1.5	-
Real estate activities	471.0	3.2	3.2	471.0	(7.2)
Administrative and support service activities	5.3	-	-	5.3	(0.4)
Education	0.3	-	-	0.3	-
Other services	1.4	-	-	1.4	-
<b>Total</b>	<b>511.5</b>	<b>6.2</b>	<b>6.2</b>	<b>511.5</b>	<b>(9.0)</b>

As at 31 December 2023 the Society's foreclosed assets obtained from non-performing exposures was a total value of £1.8m (2022: £3.7m) at recognition, which all related to residential immovable property. There was no accumulated negative changes to this value throughout the year.

Collateral obtained by taking possession and execution processes – vintage breakdown (UK CQ8)

2023	Collateral obtained by taking possession*	
	Value at initial recognition £m	Accumulated negative changes £m
<b>Other than PP&amp;E</b>	<b>1.8</b>	<b>-</b>
Residential immovable property	0.7	-
Commercial immovable property	1.1	-
<b>Total</b>	<b>1.8</b>	<b>-</b>

2022	Collateral obtained by taking possession*	
	Value at initial recognition £m	Accumulated negative changes £m
<b>Other than PP&amp;E</b>	<b>3.7</b>	<b>-</b>
Residential immovable property	1.3	-
Commercial immovable property	2.4	-
<b>Total</b>	<b>3.7</b>	<b>-</b>

\*All values at initial recognition for collateral obtained by taking possession are recognised in the balance sheet for 2 years or less at the reporting reference date.



# Appendix A – Remuneration

The following table displays the 2023 remuneration for the Society's managers and members of staff deemed as Material Risk Takers (MRT), as defined by the Remuneration Code. This includes Executive and Non-Executive Directors.

The Report of the Remuneration Committee contained within the 2023 Annual Report and Accounts contains the following:

- The decision making process used for determining the remuneration policy
- The link between pay and performance
- The most important remuneration design characteristics

## Remuneration awarded for the financial year (UK REM1)

£000s		MB Supervisory Function	MB Management Function	Other Senior Management	Other Identified Staff
Fixed Remuneration	Number of identified staff (#)	6	7	18	7
	Total fixed remuneration	469.7	1,943.5	2,131.2	683.5
	Of which: Cash-based	469.7	1,943.5	2,131.2	683.5
Variable Remuneration	Number of identified staff (#)	-	7	18	6
	Total variable remuneration	-	595.3	450.5	70.0
	Of which: Cash-based	-	595.3	450.5	70.0
	Of which: Deferred	-	165.5	93.8	3.4
<b>Total Remuneration</b>		<b>469.7</b>	<b>2,538.8</b>	<b>2,581.7</b>	<b>753.5</b>

## Special payments to identified staff (UK REM2)

£000s	MB Supervisory Function	MB Management Function	Other Senior Management	Other Identified Staff
<b>Severance payments awarded in previous periods, that have been paid out during the financial year</b>				
Severance payments awarded in previous periods, that have been paid out during the financial year - Number of identified staff	-	-	-	-
Severance payments awarded in previous periods, that have been paid out during the financial year - Total amount	-	-	-	-
<b>Severance payments awarded during the financial year</b>				
Severance payments awarded during the financial year - Number of identified staff (#)	-	-	2	-
Severance payments awarded during the financial year - Total amount	-	-	101,000	-
Of which paid during the financial year	-	-	101,000	-
Of which deferred	-	-	-	-
Of which severance payments paid during the financial year, that are not taken into account in the bonus cap	-	-	-	-
Of which highest payment that has been awarded to a single person	-	-	54,833	-

### Deferred remuneration (UK REM3)

£000s	Total amount of deferred remuneration awarded for previous performance periods	Total amount of deferred remuneration awarded before the financial year actually paid out in the financial year
<b>MB Supervisory Function</b>	-	-
Cash-based	-	-
<b>MB Management Function</b>	267.3	183.4
Cash-based	267.3	183.4
<b>Other Senior Management</b>	190.2	131.2
Cash-based	190.2	131.2
<b>Other Identified Staff</b>	-	-
Cash-based	-	-
<b>Total Amount</b>	<b>457.5</b>	<b>314.6</b>

### Information on remuneration of identified staff (UK REM5)

£000s	Management Body Remuneration			Business Area	
	MB Supervisory Function	MB Management Function	Total MB	Retail Banking	Total
<b>Total number of identified staff (#)</b>					38
Of which: members of the MB (#)	6	7	13		
Of which: other senior management (#)				18	
Of which: other identified staff (#)				7	
<b>Total remuneration of identified staff</b>	469.7	2,538.8	3,008.5	3,335.3	
Of which: variable remuneration	-	595.3	595.3	520.5	
Of which: fixed remuneration	469.7	1,943.5	2,413.2	2,814.8	

# Appendix B – Asset Encumbrance

The following disclosures are presented in the format prescribed by the PRA:

## Encumbered and unencumbered assets (UK AE1)

Dec 2023	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
<b>Assets of the reporting institution</b>	<b>2,901.0</b>		<b>9,625.6</b>	
Equity instruments	-	-	-	-
Debt securities	-	-	317.5	317.5
Other assets	2,901.0		9,308.1	

Dec 2022	Carrying amount of encumbered assets £m	Fair value of encumbered assets £m	Carrying amount of unencumbered assets £m	Fair value of unencumbered assets £m
<b>Assets of the reporting institution</b>	<b>2,383.1</b>		<b>8,874.2</b>	
Equity instruments	-	-	-	-
Debt securities	-	-	160.2	160.2
Other assets	2,383.1		8,714.0	

\*Other assets include derivative financial assets; property plant and equipment; intangible assets; prepayments and deferred tax assets. These assets would not be available for encumbrance in the normal course of business.

## Collateral received and own debt securities issued (UK AE2)

The PRA waived the Template AE2 requirements subject to a firm meeting certain criteria. The Society meets the criteria and therefore Template AE2 is not disclosed.

## Sources of encumbrance (UK AE3)

Dec 2023	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	2,378.0	2,709.3

Dec 2022	Matching liabilities, contingent liabilities or securities lent £m	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered £m
Carrying amount of selected financial liabilities	1,900.6	2,203.4

## Information on encumbrance (UK AE4)

The most material sources of encumbrance for the Society are secured funding via the Society's securitisation programmes which are supported by pledging mortgage assets. Further detail on these activities is set out in Section 8 of this document and note 18 to the 2023 Annual Report and Accounts.

A further source of encumbrance arises in relation to the collateralisation of the Society's derivative contracts.

# Appendix C – Leverage Ratio disclosure templates

## Summary reconciliation of accounting assets and leverage ratio exposures (UK LR1)

	Dec 2023 £m	Dec 2022 £m
Total Assets as per published financial statements	12,526.6	11,257.3
Adjustment for derivative financial instruments	(232.2)	(100.5)
Adjustment for off-balance sheet items	703.9	562.2
Other adjustments	(29.0)	(20.6)
<b>Leverage ratio total exposure measure</b>	<b>12,969.3</b>	<b>11,698.4</b>

## Leverage ratio common disclosure (UK LR2)

	Dec 2023 End State £m	Dec 2023 Transitional £m	Dec 2022 End State £m	Dec 2022 Transitional £m
On balance sheet items (excluding derivatives, SFTs and fiduciary assets, but including collateral)	12,217.8	12,217.8	10,888.2	10,888.2
Adjustments for negative FV exposure	32.3	32.3	225.8	225.8
Asset amounts adjusted in determining Tier 1 capital	(29.0)	(29.0)	(20.6)	(20.6)
<b>Total on balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)</b>	<b>12,221.1</b>	<b>12,221.1</b>	<b>11,093.4</b>	<b>11,093.4</b>
<b>Total derivative exposure</b>	<b>44.3</b>	<b>44.3</b>	<b>42.8</b>	<b>42.8</b>
Off balance sheet exposures at gross notional amount	764.8	764.8	647.0	647.0
Adjustments for conversion to credit equivalent amounts	(60.9)	(60.9)	(84.8)	(84.8)
Total of other off balance sheet exposures	703.9	703.9	562.2	562.2
Tier 1 Capital	686.9	688.1	652.7*	658.2
<b>Leverage ratio total exposure amount</b>	<b>12,969.3</b>	<b>12,969.3</b>	<b>11,698.4</b>	<b>11,698.4</b>
Claims on central bank	(1,372.5)	(1,372.5)	(1,565.3)	(1,565.3)
<b>Leverage ratio total exposure amount excluding central banks</b>	<b>11,596.8</b>	<b>11,596.8</b>	<b>10,133.1</b>	<b>10,133.1</b>
<b>Leverage ratio excluding claims on central banks</b>	<b>5.92%</b>	<b>5.93%</b>	<b>6.44%*</b>	<b>6.50%</b>
<b>Leverage ratio including claims on central banks</b>	<b>5.30%</b>	<b>5.31%</b>	<b>5.58%*</b>	<b>5.63%</b>

\*2022 end state position has been restated following correction being required to the Tier 1 capital and Leverage ratio in the disclosure.

### Split of on balance sheet exposures (excluding derivatives, SFTs and exempted exposures (UK LR3))

	Dec 2023 £m	Dec 2022 £m
<b>Total on balance sheet exposures (excluding derivatives, SFTs and fiduciary assets)</b>	<b>12,217.8</b>	<b>10,888.2</b>
<b>Banking book exposures, of which:</b>	<b>12,217.8</b>	<b>10,888.2</b>
Covered Bonds	189.4	97.5
Exposures treated as sovereign	1,396.5	1,612.6
Exposures to regional governments, MDB, International organisations and PSE not treated as sovereigns	-	-
Institutions	340.4	281.1
Secured by mortgages of immovable properties	10,152.2	9,045.9
Adjustments for negative FV exposure	(32.3)	(225.8)
Retail exposures	2.3	2.8
Corporate	-	-
Exposures in default	44.2	32.7
Other exposures (e.g. equity, securitisations and other non-credit obligation assets)	125.1	41.4

### Qualitative information on the leverage ratio (UK LRA)

The Society leverage ratio is a key indicator and is monitored by the Board regularly. The leverage ratio is projected over the Society's planning horizon and is included in stress tests to ensure that the risk of excessive leverage is managed.

The Society's leverage ratios have decreased year on year due to the growth in balance sheet exposures of the Society's in comparison to the growth of Tier 1 capital.



# Appendix D – Countercyclical Capital Buffer

The tables below contain the geographic distribution of credit risk exposures relevant for the calculation of the Countercyclical Capital Buffer for 31 December 2023. For the purposes of this calculation, this includes retail and commercial mortgage loans, treasury assets, securitisations and other assets.

In accordance with Regulation (EU) 1152/2014, as foreign credit exposures represent less than 2% of the Society's aggregate risk weighted exposures, all exposures have been allocated to the UK. The Society has a £24.1m exposure to a multilateral bond as at 31 December 2023 (2022: £48.1m).

## Geographical distribution of credit exposures for the calculation of the countercyclical buffer (UK CCyB1)

Breakdown by Country	General credit exposures		Securitisation exposure		Own funds requirements				Own funds requirement weights	Countercyclical capital buffer rate
	Exposure value for SA £m	Exposure value for IRB £m	Exposure value for SA £m	Exposure value for IRB £m	Of which: General credit exposures £m	Of which: Trading book exposures £m	Of which: Securitisation exposures £m	Total £m		
UK	2,258.1	10,980.8	-	-	231.3	-	-	231.3	100%	2%

## Amount of institution-specific countercyclical capital buffer (UK CCyB2)

Total risk exposure amount (£m)	3,160.0
Institution specific countercyclical buffer rate	2%
Institution specific countercyclical buffer requirement (£m)	63.2

# Glossary of Terms

<b>Administered Rate</b>	A rate which is set by the Society, such as SVR, and that is at the Society's discretion to change, subject to the terms and conditions of the product.
<b>AVA</b>	Additional Value Adjustment. The prudential valuation of all fair valued assets which, as per CRR article 34, is deducted from CET1.
<b>Basel II</b>	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel II became law in the EU Capital Requirements Directive and was implemented in the UK via the PRA Handbook.
<b>Basel III</b>	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Basel III became law in the EU Capital Requirements Directive IV and was implemented in the UK via the PRA/FCA Handbook on the 1 January 2014.
<b>Basis Risk</b>	Basis risk is the exposure arising from the imperfect correlation between re-pricing of interest rates on different assets and liabilities.
<b>CCB</b>	Capital Conservation Buffer. A buffer of 2.5% of Common Equity Tier 1 capital held outside periods of stress. Phased in from 2016 to 2020.
<b>CCyB</b>	Counter-Cyclical Capital Buffer. Based on national circumstances, a Common Equity Tier 1 capital buffer.
<b>CCF</b>	Credit Conversion Factor. An estimation of the drawdown of an undrawn facility.
<b>CET1</b>	Common Equity Tier 1 replaces the Core Tier 1 expression used previously for the best quality capital. In the Society's instance this consists mainly of retained earnings.
<b>Counterparty Credit Risk</b>	Counterparty credit risk is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
<b>CQS (Credit Quality Steps)</b>	A credit quality assessment scale is set out in Part III Title 2 Chapter 2 Section 1 of CRR (Applicable for Risk weights under the standardised approach to credit risk and Securitisation).
<b>CRD IV</b>	Capital Requirements Directive IV. This implements Basel III through national law.
<b>Credit risk</b>	The risk that a borrower or counterparty fails to pay the interest or to repay the capital on a loan. Credit risk is the largest risk category to which the Society is exposed and sub-divided as follows: retail lending, commercial lending, and Treasury credit risks.
<b>Credit risk mitigation</b>	Techniques to reduce the potential loss in the event that a customer (borrower or counterparty) becomes unable to meet its obligations. This may include the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, credit insurance, set off or netting.
<b>CVA</b>	Credit Valuation Adjustment. The adjustment reflects the current market value of the credit risk of the counterparty to the institution.
<b>EAD</b>	Exposure at Default. An estimate of the outstanding balance if the customer does default.

<b>ECAI</b>	External Credit Assessment Institution. An ECAI (e.g. Moody's, Standard and Poor's and Fitch) is an institution that assigns credit ratings to issuers of certain types of debt obligations as well as the debt instruments themselves.
<b>FCA</b>	Financial Conduct Authority. The financial services industry regulator in the UK for Conduct issues.
<b>Guarantee</b>	An agreement by a third party to cover the potential loss to a credit institution should a specified counterparty default on their obligations.
<b>ICAAP</b>	Internal Capital Adequacy Assessment Process. The Society's own assessment, as part of Basel III requirements, of the levels of capital that it needs to hold in respect of its regulatory capital requirements (for credit, market and operational risks) and for other risks including stress events.
<b>ILAAP</b>	Internal Liquidity Adequacy Assessment Process. The Society's own assessment of the levels of liquidity that it needs to meet its current and financial obligations. These are assessed under normal and stressed condition.
<b>Interest rate risk</b>	Interest rate risk is the exposure of a firm's financial condition to adverse movements in interest rates.
<b>IRB</b>	Internal Ratings Based approach. A Basel III approach for measuring exposure to credit risks. IRB approaches are more sophisticated and risk-sensitive than the Standardised Approach and may only be used with PRA permission.
<b>IRRBB</b>	Interest rate risk in banking book.
<b>LCR</b>	Liquidity Coverage Ratio. A liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30 calendar day time horizon under a severe stress scenario.
<b>LIBOR</b>	London Inter Bank Offered Rate.
<b>LGD</b>	Loss Given Default. An estimate of the outstanding balance not recovered and the costs associated with that recovery process.
<b>LTV</b>	Loan To Value. A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Society calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a regular basis to reflect changes in the house price index (HPI)).
<b>Maturity</b>	The remaining time in years that a borrower is permitted to take to fully discharge their contractual obligation (principal, interest and fees) under the terms of a loan agreement.
<b>Minimum capital requirement</b>	The minimum amount of regulatory capital that a financial institution must hold to meet the Basel III Pillar 1 requirements for credit and operational risk.
<b>Netting</b>	The ability to reduce credit risk exposures by offsetting the value of any deposits against loans to the same counterparty.
<b>MREL</b>	Minimum Requirement for own funds and Eligible Liabilities. An amount set by regulators based on an assessment of the institution.
<b>Operational risk</b>	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events.
<b>PD</b>	Probability of Default. The probability of defaulting in the next 12 months.

<b>Pillar 1</b>	The part of the Basel III Framework which sets out the regulatory minimum capital requirements for credit and operational risk.
<b>Pillar 2</b>	The part of the Basel III Framework which sets out the processes by which financial institutions review their overall capital adequacy. Supervisors then evaluate how well financial institutions are assessing their risks and take appropriate actions in response to the assessments. This includes all risks (including Pillar 1 risks) – ICG is an outcome from Pillar 2.
<b>Pillar 3</b>	The part of the Basel III Framework which sets out the disclosure requirements for firms to publish details of their risks, capital and risk management. The aims are greater transparency and strengthening market discipline.
<b>Planning Horizon</b>	Planning horizon relates to the Society's medium term plan.
<b>PMA</b>	Adjustments applied when the Society considers that a modelled output is not sufficiently accurate or complete due to there being potential for additional risks that have not been identified or that cannot be adequately modelled.
<b>PRA</b>	Prudential Regulation Authority. The financial services industry regulator in the UK for prudential risk.
<b>Provisions</b>	Amounts set aside to cover losses associated with credit risks.
<b>QCCP</b>	Qualifying Central Counterparty. A qualifying central counterparty is an entity that is licensed to operate as a CCP and is permitted by the regulator to operate as such with respect to the products offered.
<b>RWEA</b>	Risk Weight Exposure Amount. The amount of the exposure value multiplied by the risk weight associated with the exposure.
<b>RWEA Density</b>	RWEA divided by the total EAD Post-CRM.
<b>Securitisation</b>	A process by which a Society's assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. A company transfers assets to a special purpose vehicle (SPE) which then issues securities backed by the assets. The Society has established securitisation structures as part of its funding activities. These securitisation structures use retail mortgages as the asset pool.
<b>Slots</b>	The categories that loans are assigned to under the specialised lending approach. There are 5 slots, 4 for non-default obligors and one for default obligors. Each slot has a prescribed risk weight and expected loss percentage that is applied to the loans.
<b>SME</b>	A small to medium sized enterprise.
<b>SPE</b>	Special Purpose Entities. Entities that are created to accomplish a narrow and well defined objective. There are often specific restrictions or limits around their ongoing activities. The Society uses an SPE set up under securitisation issue. Where the Society has control of these entities or retains the risks and rewards relating to them they are consolidated within the Society's results. This term is used interchangeably with SPV (special purpose vehicle).
<b>Stress testing</b>	Various techniques that are used by the Society to gauge the potential vulnerability to exceptional but plausible events.

<b>SREP</b>	Supervisory Review and Evaluation Process. (CRD IV Section III, the PRA's process for reviewing the adequacy of a firm's ICAAP).
<b>Subordinated debt</b>	A form of Tier 2 capital that is unsecured and ranks behind the claims of all depositors, creditors, and investing Members but before the claims of holders of permanent interest-bearing shares.
<b>TCR</b>	Total Capital Requirement. The total amount of capital an institution needs to hold to meet Pillar 1 and Pillar 2 capital requirements. Replaced the previous individual capital guidance (ICG) terminology as of 1 January 2018.
<b>The Standardised Approach (credit risks)</b>	The basic method used to calculate credit risk capital requirements under Basel III. In this approach the risk weights used in the capital calculation are determined by PRA supervisory parameters. The standardised approach is less risk-sensitive than IRB.
<b>The Standardised Approach (operational risks)</b>	The standardised approach to operational risk, calculated using the average of three year historical net income multiplied by a factor of 12-18%, depending on the underlying business being considered.
<b>Total Remuneration</b>	The sum of fixed pay, variable pay, director fees, car allowance, pension and benefits in kind.





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