# ANNUAL REPORT AND ACCOUNTS

31 DECEMBER 2022

HTB

## Hampshire Trust Bank PLC

Company number: 1311315

**Non- Executive Directors**

Robert Sharpe (Chairman)

Robert East (resigned 30/06/2022)

Astrid Grey (resigned on 30/06/2022)

Richard Price

Martyn Scrivens

Dominic Slade

Richard Sommers (appointed on 01/06/2022)

Julia Warrack (appointed on 01/07/2022)

**Executive Directors**

Matthew Wyles (Chief Executive Officer)

Timothy Blackwell (Chief Financial Officer)

**Secretary & Registered Office**

Scott Southgate (Secretary)
55 Bishopsgate,
London
EC2N 3AS

**Independent Auditor**

KPMG LLP
15 Canada Square,
Canary Wharf,
London
E14 5GL

# 1 Strategic Report

# Key Highlights – HTB Group (the Group) and HTB (the Bank)

### Record profitability providing strong shareholder returns, supporting growth and investment

- HTB Group profit before credit losses & tax £96m (2021: £27m)
- 56% Return on HTB Group Required Equity driven by strong underlying HTB Bank performance and £49m Gain on bargain purchase (GOBP) recognised on acquisition of WBL
- 40% growth in HTB Bank underlying operating income to £103m (2021: £73m)
- 94% growth in HTB Bank's profit before credit losses, dividends & tax to £52m (2021: £27m) reflecting strong asset growth and positive jaws
- 29% Return on HTB Bank Required Equity (2021: 23%)

### Continuing to build our HTB Bank franchises

- 31% growth in HTB Bank loans and advances to customers to £2,247m (2021: £1,715m)
- 27% growth in HTB Bank new lending volume to £1,071m (2021: £840m)
- 48% growth in HTB Bank deposits to £2,421m (2021: £1,633m)

### Delivering strong HTB Bank margins through disciplined pricing

- 7.3% Gross Income Margin (2021: 6.1%) reflecting asset yield discipline and rising interest rates.
- 1.4% Blended Cost of Funds (2021: 1.2%) reflecting tight control of funding costs
- 5.2% Underlying Net Revenue Margin (2021: 4.8%) reflecting overall strong margin management

### Investing in our HTB Bank operating platform to support future growth

- Growth in HTB Bank Team to 347 (2021: 281) delivering on our growth strategy
- Continued investment in technology, with £4.8m additions to intangible assets (2021: £3.3m) enhancing our customer propositions
- Maintaining cost discipline and increasing efficiency with HTB Bank Underlying Cost to Asset Ratio 2.6% (2021: 3.0%)

### Impairment charges reflect the forward-looking recognition of potential credit losses under IFRS

- Stable HTB Bank coverage ratio of 0.61% (2021: 0.65%) reflective of an uncertain future economic outlook with forward-looking IFRS9 provisions increased to £14.4m (2021: £11.2m)

### Strong capital and liquidity position providing resilience and support for future growth

- Strong Group CET1 Ratio of 16% (2021: 19%) and strong Group Total Capital Ratio of 19% (2021: 22%) having absorbed the net impact of the WBL acquisition
- Small increase in RWA density, reflecting a change in HTB Bank product mix to 52% (2021: 48%) and a greater density in assets acquired giving a blended group density of 55%.
- Conservative liquidity levels maintained with HTB Bank Liquidity Coverage Ratio of 285% (2021: 314%)

## Chairman's Overview

**Robert Sharpe**

Chairman

We began 2022 hoping and expecting a year in which UK PLC recovered further from the vicissitudes of the Covid pandemic and Government policy began to address the needs of an economy still adjusting to Brexit and the loss of free access to a market of 450 million people.

Within a month, our hopes were dashed by the shocking evidence that the Russian build up on the Ukrainian border was not a military exercise but the precursor to an invasion. Our CEO, in his report, has summarised the events which followed and their macro-economic consequences. Suffice it to say that we do not anticipate an early resolution of the conflict in Ukraine and an end to the appalling suffering of the Ukrainian people. We are planning the development of our business based on this central case assumption.

Despite all of the headwinds which the Group faced during 2022, we have delivered another record-breaking set of results. Over the course of the last five years (2017 to 2022), HTB Group has grown its balance sheet by over 370% to £3.5bn of total assets with equally impressive growth in both lending assets and profitability. This is testament to two important facts. First, that the strategy we call Excellence through Specialism, which we implemented in early 2018, has been very successful and, secondly, that the focus and determination of our people in driving our success has been exemplary. A winning strategy complemented by excellent and consistent execution is the blueprint of our achievements.

Whilst celebrating our successes, we know that there is no room for complacency. 2023 will, no doubt, prove to be another challenging year and the Board is united in its determination to focus on identifying emerging risks and managing them effectively through the continuing development and maturation of our risk management framework. In addition to credit risk, we will particularly focus on a number of key operational risks including cyber and climate change. The Financial Conduct Authority's Consumer Duty initiative will be implemented in mid-2023 and both Board and Executive are tightly focused on ensuring the Group is properly aligned with and compliant with the requirements of the regime when it goes live.

I have been fortunate as Chairman in being supported by a talented and highly capable Board since I was appointed in late 2017. I was delighted to welcome two new non-executive directors to the Board during 2022. Richard Sommers, who has had a distinguished career in banking, joined us in June to chair the Board Risk Committee in succession to the redoubtable Robert East who left to take up the chairmanship of a leading challenger bank. Both the Executive and Non-Executive have already benefited hugely from Richard's rigorous and insightful approach. Hot on Richard's heels, Julia Warrack joined us in July, also as a non-executive director. Julia's background and experience is centred on technology, process design and operational excellence. She brings a fresh and incisive perspective to our deliberations and brings a valuable new set of capabilities to the Group Board.

I was also very grateful to Martyn Scrivens, HTB's Chair of Audit, who separately took on the additional responsibility of the Chair of the Wesleyan Bank Limited (WBL) Board from the date upon which we concluded the acquisition. Martyn quickly assembled an excellent subsidiary Board which included two highly capable existing WBL non-executive directors, Jeremy Brettell (WBL Chair of Audit) and Bill Gray (WBL Chair of Risk).

Alex Leicester, a partner in Alchemy Partners (our principal shareholders) made a key contribution to the successful acquisition of WBL and I am very grateful to him for accepting a seat on the WBL Board where we can continue to benefit from his knowledge and expertise.

Finally, I want to thank the entire HTB Group team, the intermediaries who introduce new business, our customers and our shareholders for their continued support.

While our 2022 financial results achieved a significant milestone, the Board and I understand there is more to do. We will continue to execute our well-articulated, focused strategy in 2023. Matthew and his capable management team will continue to move the Bank forward at pace with growth in sustainable earnings, ongoing performance improvement and enhanced shareholder value.

**Robert Sharpe**

Chairman

# Chief Executive's Report

## Matthew Wyles

Chief Executive

2022 was the first year in which we traded with two banks within the Group, following our acquisition of Wesleyan Bank Limited which became a wholly owned subsidiary of Hampshire Trust Bank PLC (HTB) on 28 February 2022.

Following a strategic review, we took the decision to cease lending in Wesleyan Bank and to put the existing portfolio into run-off, whilst transferring any continuing new business activity to HTB. This approach had the key advantage of greatly reducing the extent of the integration which would otherwise have been required in merging two actively trading entities. It is our intention to migrate the capital base of Wesleyan Bank, over time, to the HTB balance sheet where it will be deployed optimally in growing our core franchise.

I was delighted by the way the HTB and Wesleyan teams came together and worked in lockstep to deliver the first stage of the integration programme which ran ahead of our plan timelines. HTB received its first dividend of £20m from Wesleyan Bank at the end of 2022. Whilst we have more work to do as we continue to harvest the benefits of the transaction, much of the heavy lifting is now complete and the path to completion of our plan is clear and open. The acquisition has added further to our scale and, at 31 December 2022, Group net lending assets stood at £2.65bn and the balance sheet as a whole stood at just over £3.5bn.

The recovery of the UK economy, which started during 2021 following the sharp, Covid related contraction of 2020, was disrupted by the Russian invasion of Ukraine in February 2022 and the international sanctions which followed. This crisis drove up wholesale energy and commodity prices and the result was inflation, the like of which we had not seen in the UK for over 30 years. The Office of National Statistics Consumer Prices Index which includes owner occupiers' housing costs (CPIH) rose by 9.2% in the 12 months to December 2022.

This, in turn, triggered a round of monetary tightening by central banks in the US, the UK and the EU. The Bank of England Base Rate rose from an all-time low of 0.10% at the end of 2021 to 3.50% a year later and ended the era of ultra-low interest rates which had prevailed since the Global Financial Crisis in 2008. This rapid increase in interest rates was inevitably reflected in borrowing costs for consumers and businesses. According to Oxford Economics' analysis in early 2023, the UK's GDP contracted quarter by quarter over the course of 2022. To compound these headwinds, there was turmoil in Government which resulted in not one, but two changes of Prime Minister during the Autumn.

Despite what many will characterise as an annus horribilis, the core HTB franchise delivered a robust performance. Net interest income grew 43%, primarily driven by 31% growth in lending assets and sustained by our continued discipline in maintaining margins during the year. The growth in our Asset Finance, Wholesale and Development Finance portfolios at attractive yields fuelled further improvement in net interest margin. At the same time, the Bank's operational agility enabled us to be opportunistic in the Savings market and we were successful in buffering the impact of rising interest rates on our funding costs. HTB's underlying Net Revenue Margin rose from 4.8% to 5.2%.

HTB Bank's profit before tax and dividends was up 63% on 2021 to £44.5m with a return on required equity (post tax) of 29%.

We continued to invest in building our team bench strength across both front and back office functions during 2022 and HTB's headcount rose from 281 to 347. The Bank committed further capital expenditure to support its drive to increase efficiency across its operations and in further technological developments to support key processes. Despite our investment in people and technology, the Bank achieved a significant reduction in underlying cost / income ratio of 15%, down to 49%.

HTB Bank's losses & provisions line in 2022 increased to £7.3m, principally as a consequence of the forward-looking impact of the IFRS9 accounting standard which requires us to recognise the macro-economic uncertainties currently prevailing in the UK and their potential impact on credit losses in the future. Whilst we will continue to monitor closely the credit performance of our loan portfolios, we are confident that the underlying soundness of our lending and the experience we acquired during the Covid pandemic in supporting customers through periods of economic uncertainty will stand us in good stead. Nevertheless, we have selectively increased the resourcing of the operational units handling collections and recoveries to ensure that we are properly prepared for any turbulence yet to come.

Our corporate philosophy of Excellence through Specialism means that we drive the growth of our franchise, not through price, but by delighting our customers and a key measure of our success, therefore, is the level of our customers' advocacy and approval. We won an impressive collection of awards during the year including:

- Bridging & Commercial Specialist Buy to Let Lender of the Year
- Business Moneyfacts Best Service from a Specialist Buy to Let Provider
- Business Moneyfacts Best Service from a Buy to Let Mortgage Provider (3rd year running)
- Leasing World Customer Service Excellence Awards - Top Customer Centric Culture award
- Leasing World Gold Awards - Broker Deal of the Year
- Moneyfacts Best Business Fixed Account Provider (6th year running)
- Moneynet Best Overall Business Savings Provider
- Feefo Platinum Service Award (3rd year running)

During 2022 we witnessed further evidence of the impact of climate change on the planet. According to the World Meteorological Organisation, the global mean temperature in 2022 is estimated to be about 1.15°C above the 1850-1900 pre-industrial average. We recognise that HTB must, as a socially responsible institution, maintain a clear focus on its environmental responsibilities and play its part in halting global warming. To that end, I am pleased to report that we achieved carbon neutral status during 2022. We recognise, however, that we have more to do in reducing and rationalising our carbon footprint.

High quality people sit front and centre of HTB's operating model and its business strategy. Our philosophy is to seek out the best talent available and our objective is to be a "go-to" employer in our markets. The competition for talent has never been hotter and we recognise that, not only must we reward our people well, we must sustain an ethos which treats personal development and employee well-being as fundamental. I want to thank the whole of Team HTB for their hard work, their commitment and their loyalty during 2022. They are the magic ingredient in the HTB formula.

I also want to thank our non-executive directors for their invaluable contribution during 2022. HTB's Board members are highly skilled at balancing the rigour of their supervision with sound commercial judgement.

They assist me and my executive colleagues with thoughtful, constructive challenge, insightful advice and motivational support. Lastly, I want to restate my gratitude to our principal shareholders, Alchemy Partners, for their steadfast support and unwavering commitment to our mission.

**Matthew Wyles**

Chief Executive Officer

# Financial and Business Review

## Financial Performance Indicators

Certain Financial Measures disclosed in the Annual Report and Accounts do not have a standardised meaning prescribed by international accounting standards and may not therefore be comparable to similar measures presented by other issuers. These measures are considered 'alternative performance measures' (Non-GAAP financial measures) and are not a substitute for measures prescribed by international accounting standards. Definitions of financial performance indicators referred to in the Strategic Report (in alphabetical order) are set out below.

| | |
|---|---|
| Average principal employed | Calculated as the average Loans and Advances to customers held at amortised cost and fair value. |
| Blended cost of funds (after hedging) | Rate of interest payable on average funding excluding Tier 2 adjusted for interest on interest rate swap liabilities. |
| Common Equity Tier 1 Ratio (CET1 Ratio) | Common equity tier 1 capital (note 37) divided by risk-weighted assets as reported per the current year end COREP Submission. |
| Cost of Risk | Impairment on financial assets and net loss or gain on loans held at fair value through profit or loss (note 11) divided by average principal employed. |
| Cost to Asset Ratio | Administrative expenses divided by average principal employed |
| Cost to Income ratio | Calculated as administrative expenses divided by operating income excluding net gain or loss on loans held at fair value through profit and loss. |
| Coverage Ratio | The allowance for impairment expressed as a percentage of gross loans and advances at amortised cost. |
| Gross income margin | Total interest and similar income (note 8), fees and commission income (note 9) and net loss or gain on loans & other financial assets at fair value through profit or loss (note 10) and other income (note 11) divided by average principal employed. |
| Leverage ratio | Common Equity Tier 1 capital divided by the sum of total assets (excluding intangibles). |
| Liquidity Coverage Ratio ('LCR') | The ratio of the stock of high-quality liquid assets to expected net cash outflows over the following 30 days. High-quality liquid assets should be unencumbered, liquid in markets during a time of stress, and ideally, central bank eligible. |
| Loan to Deposit ratio | Loans and advances to customers held at amortised cost and fair value divided by customer deposits. |
| Net Interest Margin (NIM) | Net interest income divided by average principal employed. |
| Net Revenue Margin | Operating income excluding net loss or gain on loans held at fair value through profit or loss, divided by average principal employed. |
| Return on equity (post-tax) | Return on equity (post-tax) is calculated as profit post tax for the year divided by average equity. |
| Return on Required Equity | Return on Required Equity is calculated as profit post tax for the year divided by average required equity. |
| Required Equity | The amount of regulatory equity needed to achieve the required minimum common equity tier 1 ratio. |
| Risk-weighted asset (RWA) density | The ratio of RWA to customer loans provides a measure of riskiness of assets. |
| Total Capital Ratio | Common Equity Tier 1 plus Tier 2 debt and Additional Tier 1 divided by risk weighted assets. |

| | |
|---|---|
| **Underlying Cost to Asset Ratio** | Administrative expenses net of management recharges (note 11) divided by average principal employed |
| **Underlying Gross Income Margin** | Total interest and similar income (note 8), fees and commission income (note 9) and net loss or gain on loans & other financial assets at fair value through profit or loss (note 10) and other income excluding Management recharges (note 11), divided by average principal employed. |
| **Underlying Income Ratio** | Administrative expenses net of management recharges (note 11) divided by operating income excluding net gain or loss on loans held at fair value through profit and loss (note 10) and management recharges (note 11). |
| **Underlying Net Revenue Margin** | Operating income excluding net loss or gain on loans held at fair value through profit or loss (note 10) and management recharges (note 11), divided by average principal employed. |

| | Group 2022 £m | Bank 2022 £m | Group and Bank 2021 £m |
|---|---|---|---|
| Loans and Advances to Banks | **463** | **459** | **242** |
| Investment Securities | **262** | **218** | **197** |
| Loans at fair value through profit or loss – *Development Finance* | **4** | **4** | **10** |
| Loans and advances to customers: | **2,650** | **2,243** | **1,705** |
| *Specialist Mortgages* | 1,608 | 1,609 | 1,295 |
| *Development Finance* | 222 | 222 | 146 |
| *Asset Finance* | 375 | 246 | 170 |
| *Wholesale Finance* | 166 | 166 | 94 |
| *Commercial and Retail Finance* | 279 | - | - |
| Investment in Subsidiaries | **-** | **49** | **-** |
| Other Assets | **167** | **227** | **37** |
| **Total Assets** | **3,546** | **3,200** | **2,191** |
| Customer Deposits | 2,674 | 2,421 | 1,633 |
| Central Bank Facilities | 393 | 295 | 295 |
| Tier 2 Capital | 30 | 30 | 30 |
| Other Liabilities | 166 | 195 | 44 |
| **Total Liabilities** | **3,263** | **2,941** | **2,002** |
| **Equity** | **283** | **259** | **189** |
| **Ratios/KPIs** | | | |
| Risk weighted assets ("RWA") (£m) | **1,459** | **1,159** | **816** |
| RWA Density (RWA / Loans to Customers) | **55%** | **52%** | **48%** |
| Common Equity Tier 1 Capital (£m) | **254** | **180** | **175** |
| Additional Tier 1 Capital securities | **17** | **17** | **-** |
| Tier 2 Capital (£m) | **30** | **30** | **30** |
| Common Equity Tier 1 Ratio | **16%** | **14%** | **19%** |
| Total Capital Ratio | **19%** | **17%** | **22%** |
| Leverage ratio | **11%** | **9%** | **8%** |
| LCR | **387%** | **285%** | **314%** |
| Loan to deposits ratio | **99%** | **93%** | **105%** |

### Investment in Subsidiaries

On 28 February 2022 Hampshire Trust Bank PLC ("HTB") acquired 100% of the shares and voting rights of Wesleyan Bank Limited ("WBL") shown at cost in investment in subsidiaries, £49m (2021: Nil). The Group Balance Sheet at 31 December 2022 reflects the consolidated assets and liabilities of the WBL and its 100% owned subsidiaries.

### Liquidity

The Group had £463m (2021: £242m) in loans and advances to banks as at 31 December 2022. This represented over 17% of total deposits held (2021: 13%), including high quality liquid assets of £452m at 31 December 2022 (2021: £230m), all in the form of deposits held in the Bank of England Reserve Account. The Group also increased investment in covered bonds and Gilts with balances of £262m as at 31 December 2022 (2021: £197m). The Bank's liquidity coverage ratio ('LCR') was 285%, with a Group LCR of 387% (2021: 314%), substantially in excess of the minimum set by the PRA of 100%.

### Loans to customers

The Bank has seen strong organic growth across all of its business lines, net loans and advances to customers grew strongly by 31% reaching £2,247m as at 31 December 2022 from £1,715m as at 31 December 2021. In addition the Group loan book has grown by a further £407m to £2,654m with the acquisition of WBL's Commercial, Retail and Asset Finance portfolios. A description of the Group's principal lending activities and their associated lending book movements are set out below:

***Specialist Mortgages*** provides various forms of mortgage loans to portfolio landlords and property investors via a panel of specialist brokers. Lending comprises buy to let mortgage loans secured on residential properties, semi-commercial loans (where the property is mainly residential housing), bridging finance for property investors in the residential market and commercial investment mortgages on commercial premises. Despite challenging market conditions the Bank continues to strengthen its franchise in its chosen market segments, with the business growing 24% from £1,295m in 2021 to £1,609m in 2022, with £564m of originations.

***Development Finance*** provides finance mainly for development to well established UK SME house builders and property developers. The business lends throughout England and Wales and is mostly sourced direct from the market. There was a strong net increase of 52% in the loans and advances to customers held at amortised cost during the year from £146m in 2021 to £222m. With new business amounting to £222m (2021: £203m). The loan book continued to experience a steady flow of maturing loans as developments are successfully completed and marketed for sale by our customers with repayments amounting to £160m in 2022 (2021: £178m). The loans held at fair value through profit and loss decreased by 57% to £4m (2021: £10m) reflective of the run-off on that maturing back book of business.

***Asset Finance*** provides small to middle ticket leasing and hire purchase secured on vehicles and business assets. Finance is sourced via a network of specialist finance brokers who are serviced by a regionally based team of broker managers. Originations in the year increased by 78% to £173m (2021: £97m) as businesses continue to invest in specific asset classes despite the macro-economic uncertainty. The Bank's Asset Finance book has increased organically by 45% to £246m (2021: £170m) with the Group increasing by 120% to £374m (2021: £170m) when including the portfolio acquired with WBL.

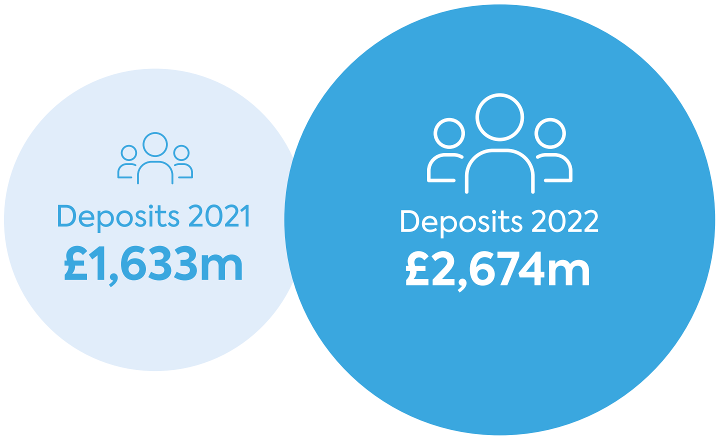
***Wholesale Finance*** provides lending facilities to a range of non-bank finance companies secured on their underlying loan receivables. The loan book increased by 77% from £94m in 2021 to £166m in 2022. The existing WBL Block Discounting portfolio was transferred at book value, £20m, to HTB in March 2022. In addition to this purchase new business increased from £50m in 2021 to £90m in 2022 as the business continues to gain momentum.

***Commercial and Retail Finance*** These portfolios have been acquired by the Group as part of the WBL lending book, following a strategic review conducted by the Group after acquisition, these business lines have been put into run off with a remaining book of £279m on 31 December 2022. Commercial lending provides specialist acquisition finance to enable the purchase of professional practices, predominantly by Dentist and Pharmacists (£272m) and the Retail portfolio consists of point of sale lending to retail customers (£7m).

## Funding

The main funding for the loan books is sourced from deposits and the Group's loan to deposit ratio at 31 December 2022 was 99% (2021: 105%). The Group is predominantly funded by deposits which are serviced by our in-house team principally through an online portal.

| | 2022<br>£m | 2021<br>£m |
|---|---|---|
| Notice deposits | 504 | 462 |
| Term deposits | 2,170 | 1,171 |
| **Total Customer Deposits** | **2,674** | **1,633** |




Deposits are principally sourced direct from the public and SMEs using a combination of on-line marketing and appearance in product best buy tables.

| | 2022<br>£m | 2021<br>£m |
|---|---|---|
| Retail deposits | 1,864 | 1,258 |
| SME deposits | 810 | 375 |
| **Total Customer Deposits** | **2,674** | **1,633** |

Deposit balances increased from £1,633m in 2021 to £2,674m in 2022. Customer numbers have risen from around 29,300 at the start of the year to around 35,300 at the year end. Qualifying deposits with the Bank are protected under the terms of the Financial Services Compensation Scheme. At 31 December 2022, 88% of deposits with a value of £2,353m were protected under the Scheme (2021: £1,417m).

In addition to Customer Deposits, the Group continued to use the Bank of England's four year TFSME (Term Funding Scheme with additional incentive for SME's) with drawn balances of £393m at 31 December 2022 (2021: £295m).

## Capital

The Group's Common Equity Tier 1 (CET1) Capital comprises ordinary share capital plus share premium, fair value through other comprehensive income reserve and retained earnings, less intangible assets. Regulatory adjustments to CET 1 consist of Prudential Valuation Adjustments and Synthetic Securitisation as a result of the Enable Guarantee Scheme.

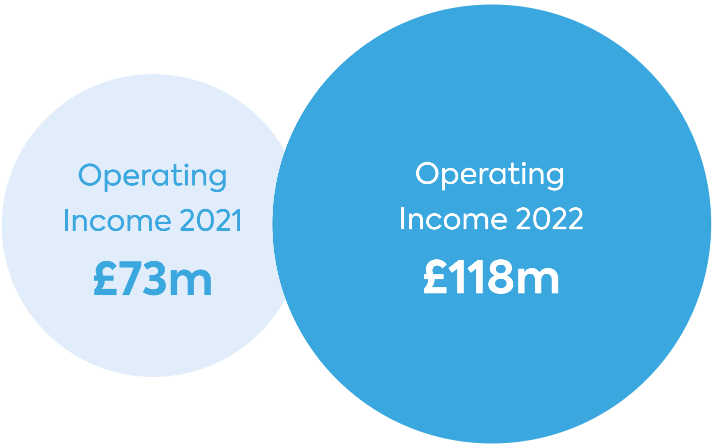
CET1 on a statutory basis as at 31 December 2022 was £254m for the Group and £180m for HTB (2021: £175m). The statutory CET1 ratio as at 31 December 2022 was 16% at the Group and 14% at the Bank level (2021: 19%). The CET1 ratio remains above our target minimum and our risk-weighted asset (RWA) density (RWA divided by customer loans) for the Bank at 31 December 2022 was 52% with 55% for the Group (2021: 48%). This resulted in a leverage ratio of 11% for Group and 9% at Bank level (2021: 8%).

| | Group 2022 £m | Bank 2022 £m | Group and Bank 2021 £m |
|---|---|---|---|
| Interest income calculated using the "EIR" method | 150 | 131 | 86 |
| Other Interest Income | 1 | 1 | 2 |
| Interest Expense and similar charges | (40) | (33) | (19) |
| Net interest income | **111** | **99** | **69** |
| Operating lease income | 2 | – | – |
| Fees and commissions income | 3 | 2 | 2 |
| Fees and commissions payable | (2) | (2) | (1) |
| Net gain/(loss) on Loans and other assets at fair value through profit or loss | 3 | 3 | 3 |
| Other income | – | 7 | – |
| Operating Income | **118** | **109** | **73** |
| Impairment gain/(losses) | (8) | (7) | 1 |
| Administrative expenses | (70) | (57) | (46) |
| Gain on bargain purchase | 49 | – | – |
| Profit before tax and dividend | **88** | **45** | **28** |
| Dividend received | – | 20 | – |
| Profit before tax | **88** | **65** | **28** |
| Tax | (10) | (11) | (7) |
| Profit for the period | **78** | **54** | **21** |
| **Underlying Operating Income** | | | |
| Operating income | **118** | 109 | 73 |
| Less management recharges (note 11) | **-** | (6) | - |
| Underlying Operating Income | **118** | 103 | 73 |
| **Ratios** | | | |
| Gross Income Margin | **6.6%** | **7.3%** | **6.1%** |
| Underlying Gross Income Margin | **6.6%** | **6.9%** | **6.1%** |
| Blended cost of funds (after hedging) | **1.4%** | **1.4%** | **1.2%** |
| Net Interest Margin | **4.7%** | **5.0%** | **4.6%** |
| Net Revenue Margin | **5.0%** | **5.5%** | **4.8%** |
| Underlying Net Revenue Margin | **5.0%** | **5.2%** | **4.8%** |
| Cost to Asset Ratio | **3.0%** | **2.9%** | **3.0%** |
| Underlying Cost to Asset Ratio | **3.0%** | **2.6%** | **3.0%** |
| Cost Income Ratio | **60%** | **52%** | **64%** |
| Underlying Cost Income Ratio | **60%** | **49%** | **64%** |
| Cost of Risk | **0.2%** | **0.2%** | **-0.3%** |
| Return on Required Equity (post tax) | **56.1%** | **29.4%** | **22.8%** |
| Return on Equity (post tax) | **32.7%** | **15.2%** | **12.1%** |

## Operating income

Group Operating income increased by £45m to £118m (2021: £73m). This principally reflects the growth in average lending assets within HTB with Bank growth in Operating Income of £36m to £109m (2021: £73m), and Bank Growth in and Underlying Operating Income of £30m to £103m (2021: £73m).

The Group Net Revenue Margin remains stable at 5.0% in 2022 (2021: 4.8%) with the Bank Net Revenue margin and Underlying Net revenue Margin strengthening to 5.5% and 5.2% respectively driven by disciplined pricing in a competitive market.




## Impairments

Reflective of ongoing economic uncertainty, there was an increase in forward-looking IFRS9 provisions within the Bank to £14.4m (2021: £11.2m) to maintain a broadly stable coverage ratio of 0.61% (2021: 0.65%), resulting in a charge to the income statement of £7.3m including write off and recoveries of £4.1m, giving a cost of risk metric of 0.2% at Bank and Group level (2021: -0.3%).

## Administrative expenses

In 2022 underlying operating income increased by 40% and 60% from £73m in 2021 for the Bank and the Group respectively compared to an increase in underlying administrative expenses of 9% and 52% for the Bank and Group from £46m in 2021.

The main expense drivers during the year were:

- **People** – continued recruitment of skilled resource has been undertaken to strengthen our capabilities, delivery and support future growth. £6m (2021: £3.6m) of variable remuneration reflecting financial performance.
- **Systems** – the impact of the Bank's continuing investment in infrastructure to drive enhanced customer propositions, efficiency and risk management.
- **Integration Activities** – Integration of the WBL and its subsidiaries into HTB Group, including redundancy costs.

## Gain on Bargain Purchase

A gain on bargain purchase has been recognised, £49m, on the acquisition of the WBL on 28 February 2022. The gain reflects the difference between the fair value of the identifiable net assets on acquisition and the total consideration for the purchase.

# Risk Management

### The Group's approach to risk

Effective risk management plays a key role in the successful execution of the Group's business strategy as encapsulated within our overarching Risk Appetite Statement – "To run a sustainable, safe and sound business that conducts its activities in a prudent and reputable manner taking into account the interests of our customers and key stakeholders".

### Risk Culture

The Board is responsible for setting the 'tone from the top' and ensuring that a strong risk culture exists across the Group. Senior Management will support this by leading in the implementation of the Risk Management Framework ("RMF"), ensuring that it is fully embedded with a strong focus on the adherence to risk appetite, monitored through its suite of risk metrics and key risk indicators. The Group uses a network of Risk Champions as departmental owners of risk related issues, providing training to other team members where required.

By taking a strategic, balanced approach to risk identification and subsequent management, the RMF's aim is to engage colleagues at all levels of HTB Group, promoting a deep understanding of the Group's approach to risk.

Through the course of 2022 the Group's Risk Management Framework has been extended into WBL and its subsidiaries to ensure all of HTB Group companies operate under one unifying RMF.

### Risk Strategy

The development and implementation of the Group's Risk Strategy is the responsibility of the Risk and Compliance team led by the Chief Risk Officer, the Executive Management team and ultimately subject to Board approval. Our risk management strategy:

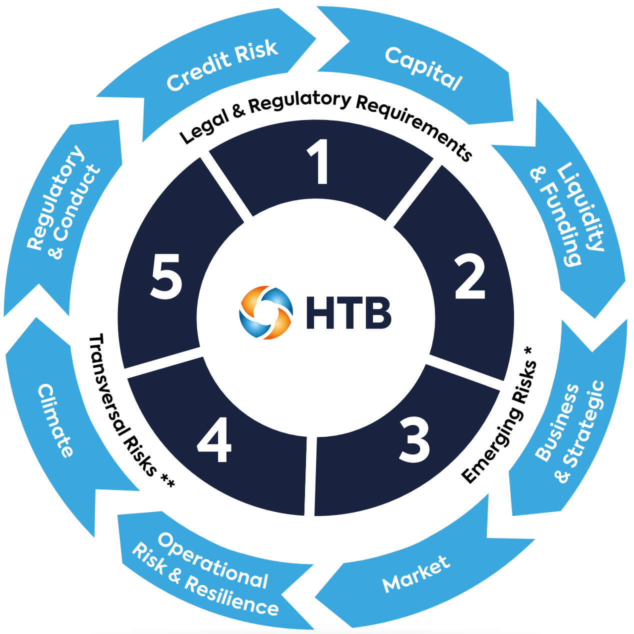
- Identifies the Principal and Emerging Risks the Group faces and how they are managed.
- Defines Risk Appetite.
- Confirms that business plans are consistent with Risk Appetite.
- Requires the Group's Risk Profile to be monitored and reported regularly.
- Tests the Group's vulnerabilities to risks under a range of stressed adverse conditions
- Includes a strong control environment.
- Allows for robust oversight and assurance.
- Encourages strong risk culture and behaviours through its linkage with the remuneration framework.

## Risk Management Framework

The Risk Management Framework ("RMF") sets parameters within which all the Group's activities are executed. This ensures we identify, monitor and report the risks to which the Group is exposed. The RMF is supported by supplemental frameworks, policies and procedures that, together, ensure that risks are managed in a manner appropriate to the size of the Group and the complexity of its operations.

The RMF addresses the legal and regulatory risks the Group is exposed to, together with the Principal and Emerging Risks. The design and effectiveness of the RMF is overseen and reviewed by the Board Risk Committee on a regular basis and at least annually.

First Line of Defence → Second Line of Defence: Oversight & Assurance → Third Line of Defence: Assurance




1. Risk culture, tone from the top, skills and resources, behaviours
2. Risk appetite and strategy, Risk appetite statements, Risk appetite framework, Business strategy
3. Risk measurement and monitoring, Risk data and models, Risk reporting, Metrics and KRIs, ICAAP / ILAAP / RRP
4. Stress testing and planning, Scenario analysis, Contingency planning

5 Risk governance and controls, Risk governance, Risk resourcing, Risk frameworks, Risk methodology

* **Emerging Risks,** Economic and Political Environment, Regulatory Change or Intervention, Competitive Landscape, Technology
** **Transversal Risks,** Reputational and ESG

Figure 1 – Risk Management Framework

### Risk Appetite Framework

The Risk Appetite Framework ("RAF") is the framework by which we clearly articulate, in a structured and systematic manner, the level and types of risk that the Group is willing to accept and must take in meeting it's business objectives. The RAF:

- Identifies, in both qualitative and quantitative terms, the type and level of risk that the Group is willing to accept across a range of business drivers (Financial, Customer, Legal and Regulatory and Reputational)
- Describes the risks that the Group is willing to take (and those that it will not) in pursuit of its corporate objectives
- Establishes a framework for decision making based on risk appetite statements and metrics
- Enables a view of risks across the whole business

The RAF is structured around the Principal Risks agreed by the Board from time to time with each Principal Risk being supplemented by a suite of more granular Supporting Risks. For each Supporting Risk, the Group articulates a Risk Appetite Statement with limits that are monitored via the use of specific Risk Appetite Metrics, with Key Risk Indicators (KRIs) providing current indication of changing risk profile. The Risk Appetite metrics are clearly measurable against the Corporate Plan, are actionable and have an assigned limit to monitor performance against the Risk Appetite. The KRIs are outcome driven with negative trends reported monthly to the relevant risk committees.

The structure of the RAF is set out in Figure 2 below.

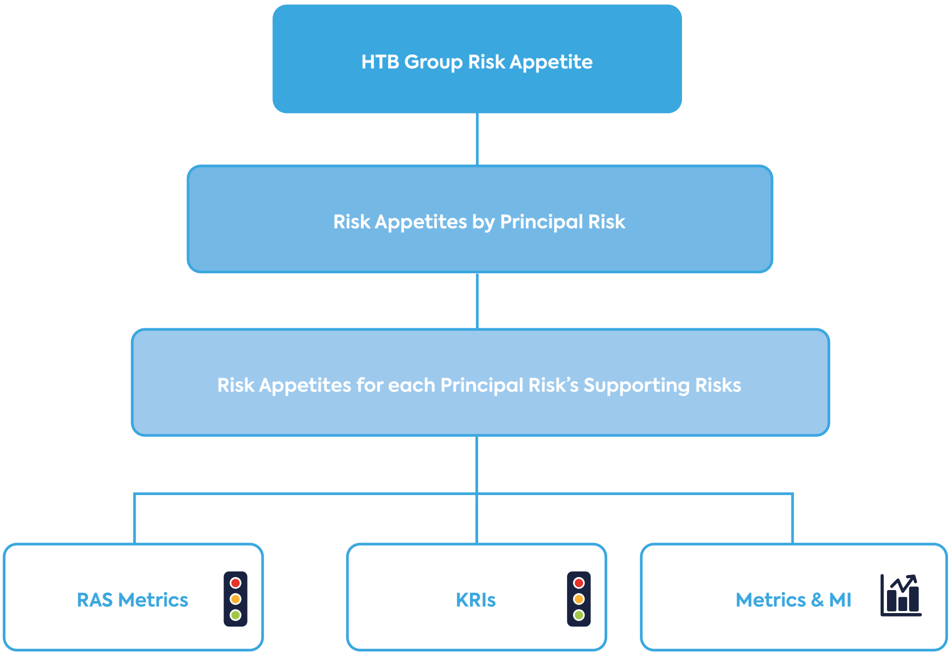



Figure 2 – Structure of the Risk Appetite Framework

Performance against Risk Appetite Metrics and KRIs is regularly reported to the Board and Board Risk Committee via appropriate sub committees.

## Risk Governance and Oversight

Risk Governance describes the design of the allocation and delegation of primary accountability, authority and responsibility for risk management across the Group by the Board. The Board reviews and approves the business strategy, ensuring it is consistent with risk appetite, and that the RMF is appropriate with sufficient governance, often through appropriate sub committees, to ensure risk appetite is being adhered to.

The Group operates a three lines of defence (3LOD) model to manage its risks. The 3LOD model provides a simple and effective way to segregate activities and enhance communications on risk management and control by clarifying essential roles and duties and enabling the Group to manage its risks proactively. The separate lines of defence together with their roles are summarised below:

***Front Line Business Units (1st line of defence)***

The business lines and central functions own primary responsibility for the day to day management of the operational level risks that feed up through the framework, and the implementation of mitigating controls in line with approved policies, frameworks, processes and procedures. They use the Group's Risk & Control Self-Assessment (RCSA) process to identify and measure risk exposure and to ensure through the application of controls that these are managed within agreed Risk Appetite. They are responsible for risk event identification and early escalation. They will also test key controls, providing regular assurance.

***Risk and Compliance Function (2nd line of defence)***

The Risk and Compliance function is independent of the business units and other central functions, and maintains the RMF, supplemental frameworks and Risk Policies. The second line provides independent challenge, oversight and ongoing assurance of the adequacy and effectiveness of risk management within the business units including oversight of the RCSA process. The Risk and Compliance function monitors performance in relation to risk appetite. It also works with Finance and Treasury on the production of the Internal Capital Adequacy Assessment Process ("ICAAP"), Internal Liquidity Adequacy Assessment Process ("ILAAP"), and the Recovery Plan and Resolution Pack ("RRP"). The adequacy and effectiveness of the second line is overseen by BRC, with evidential points including Audit Committee feedback and progress against the risk maturity roadmap on a six-monthly basis.

***Internal Audit (3rd line of defence)***

Internal Audit operates under the direction of the Board Audit Committee and provides independent assurance to the Board that the first and second lines of defence are discharging their responsibilities effectively.
The Group currently outsources this function to Deloitte, an independent professional services firm.

## Stress Testing

Stress testing is an important risk management tool for the Group and is used to inform the setting of Risk Appetite limits. Stress testing is also used to inform the Group's annual key risk assessments and determination of required buffers, forward-looking strategic planning for capital and liquidity management, and key prudential processes including the ICAAP, ILAAP, Recovery Plan and Resolution Pack.

The Group undertakes stress testing to assist the Board in understanding its key risks, and the scenarios and sensitivities that may adversely impact on its financial and/or operational performance. It does this by:

- Testing the adequacy of the Group's capital, funding and liquidity to withstand the emergence of risks under both normal and stressed conditions.
- Supporting the adequacy assessment of the potential management actions available to mitigate the effect of adverse events.
- Supporting the identification of any potential gaps in the Risk Management Framework, not readily apparent from the management of day-to-day risks.

The Board is responsible for reviewing and approving the scenarios that are used for each type of stress testing on at least an annual basis. The scenarios and the results of each stress test are reviewed by an appropriate committee (e.g. ALCO, Credit Committee) before being agreed by GEC. They will then be reported to Board Risk Committee which will provide further challenge and independent review prior to recommending to the Board for approval.

Stress testing is an ongoing requirement but may be updated, for example, by changes to the Group's business model, changes in risk appetite, changes in economic conditions or assumptions and changes in regulatory requirements.

The stress scenarios developed as part of the ICAAP are used to size a stress loss buffer which ensures that the Group can withstand a range of adverse economic scenarios over the term of its planning horizon. The ICAAP incorporates all principal risks that will impact on capital. The CFO and CRO are accountable for the ICAAP.

Similar stress scenarios are developed to support the ILAAP. These scenarios are used to size a liquidity buffer such that the Group can withstand a range of stressed liquidity scenarios in the short to medium term. The ILAAP incorporates all principal risks that will impact on Liquidity. The CFO is accountable for the ILAAP.

The Group also performs Reverse Stress Testing ("RST") to help it identify events that could cause its business to become unviable. The starting point for RST is assumed to be the point at which failure would occur and a logical approach is then taken to work back to identify the potential sequence of events that could occur to lead to that failure. If the tests reveal a risk of failure that is unacceptably high compared to risk appetite, the Board will take action to mitigate that risk.

Recovery Stress Testing is an integral part of the HTB Recovery Plan. A number of scenarios, incorporating various risk characteristics, are applied to achieve the point of 'near-default'. This allows the Group to test the calibration and effectiveness of its Recovery Indicators, and the capacity, feasibility, and suitability of its Recovery Options. Recovery Stress Testing allows the Group to demonstrate that it can identify a severe stress in a timely manner and enact sufficient actions to maintain or restore the viability of the business model.

In 2022, HTB incorporated stress testing on the financial risk associated with the physical and transitional impacts of Climate Change in its ICAAP, using both internally assessed idiosyncratic sensitivities and the macro-economic CBES scenario published by the Bank of England in 2021. Two additional internal scenarios were also developed, with the impact assessments presented to Board at the end of 2022. 2023 will see further enhancement of Climate Change Stress Testing within the Group's Stress Testing Framework.

## Principal Risks and Risk Mitigation

The Principal Risks the Group faces, and how we mitigate the risks, are described below. These should not be regarded as a comprehensive list of all the risk and uncertainties faced by the Group but rather a summary of the primary risks which have the potential to significantly impact the achievement of strategic risks:

| Principal Risk | Definition | How we mitigate the risk |
|---|---|---|
| **Business & Strategic Risk** | The uncertainty related to strategic choices such as misreading of the external environment or external change.<br><br>Setting and implementation of a wrong or uncompetitive business model or the design of products or services that produce conflicting or disruptive consequences, resulting in a failure to deliver business objectives. | • All new business initiatives and product or service propositions undergo rigorous analysis and challenge prior to launch.<br>• We ensure that benefits of investments are recorded and monitored throughout the life of investments<br>• Investment spending and prioritisation is managed through the investment committee<br>• When considering inorganic growth opportunities, we conduct due diligence to understand the risks presented<br>• We have a new product process in place to consider the risks of product launches<br>• One of our four core values is Customer Matters<br>• We have a Customer Experience programme in place to monitor customer experience and feedback<br>• We take complaints seriously and monitor them to ensure we resolve issues<br>• We have a conflict-of-interest policy and a control framework to ensure they are declared and understood<br>• We model and stress test the impact of new investments on our existing business ensuring capital, liquidity and funding requirements remain within risk appetite<br>• We consider the impact of regulatory expectations and legislative requirements whilst assessing Business and Strategic risks. |
| **Credit Risk** | The risk that a borrower or counterparty fails to pay the interest or repay the principal on a loan on time<br><br>In relation to the Group's Treasury activities there is a risk that acquired securities or cash placed on deposit with other financial institutions is not repaid in full or in part or financial transactions are not settled. | • We evidence affordability (ability to repay from cash flow)<br>• We take security and where appropriate, guarantees, to support our lending<br>• We maintain a diversified portfolio of loans by originating in markets we understand and by limiting concentrations by size proportionate to our own balance sheet size and position in the market, by asset class, collateral type, geography, sector and (where appropriate) by sub-sector<br>• We focus on sectors where we have specific expertise<br>• Credit decisions are made using a combination of Due Diligence, reviewing Credit Agency reports, reviewing financial information, credit scores and using the expert opinion of our underwriters<br>• We consider threats from climate change (e.g. flood risk and transitional energy performance legislation) in our approach to underwriting<br>• We have a Credit Risk Management Framework that includes detailed lending policies, underwriting manuals and a defined problem debt management process<br>• We undertake regular reviews of our loan portfolios and ongoing assurance testing of lending decisions and our processes<br>• We operate a Treasury policy that only allows for deposits to be placed with large Banks or invested in High Quality Liquid Assets in line with PRA guidance on Credit Ratings<br>• Lending performance against Risk Appetite is monitored regularly. |

| Principal Risk | Definition | How we mitigate the risk |
|---|---|---|
| Capital Risk | The risk that the Group will have insufficient capital to cover unexpected losses, meet regulatory requirements or support growth plans | • We operate a Capital Planning Framework which requires us to maintain appropriate levels of capital in a range of stressed scenarios<br>• We set a prudent Risk Appetite which is approved by the Board and reviewed at least annually. This considers the necessary time lag for management actions to take place. We meet, as a minimum, all regulatory prescribed ratios<br>• We monitor current and forecast levels of capital against our risk appetite and report to Asset and Liability Committee (ALCO) and the Board regularly<br>• Capital forecasts, and their compliance with our risk appetite, form an integral part of the annual budgeting process.<br>• ICAAP stress testing is well embedded and used to inform risk appetite and business strategy. |
| Liquidity, and Funding Risk | **Liquidity** – The risk that the Group is unable to meet its financial obligations as they fall due; smooth out the effect of maturity mismatches; or maintain public confidence<br><br>**Funding** – The risk that the Group is unable to continue to fund asset growth or future liquidity requirements at an affordable price | • We set a prudent Risk Appetite which is approved by the Board and reviewed at least annually. This considers the necessary time lag for management actions to take place. We meet, as a minimum, all regulatory prescribed ratios<br>• We monitor current and forecast levels of liquidity against our risk appetite and report to Asset and Liability Committee (ALCO) and the Board regularly<br>• Liquidity forecasts, and their compliance with our risk appetite, form an integral part of the annual budgeting process.<br>• ILAAP stress testing is well embedded and used to inform risk appetite and business strategy.<br>• We maintain liquidity buffers and contingency funding plans against various stressed liquidity scenarios. |
| Market Risk | The risk that changes in market prices will affect the Group's income or the value of its holdings of financial instruments counterparties and/or undermines market integrity | • We manage exposures to a very low level against our capital and earnings positions.<br>• Where possible we match the interest rate structure of assets with liabilities or deposits to create a natural hedge<br>• We use swap agreements where required to manage basis and repricing risks within appetite<br>• We capture pipeline risk (where in the behaviours of assets and liabilities do not match expectations) and optionality risk (where early terminations can worsen mismatch positions)<br>• We monitor the credit spread risk in the liquid asset portfolio<br>• We have no appetite for Foreign Exchange risk<br>• All above risks are reported to ALCO and Board against risk appetite levels |

| Principal Risk | Definition | How we mitigate the risk |
|---|---|---|
| Operational Risk & Resilience | **Operational Risk** - The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal and regulatory risk.<br><br>**Operational Resilience** – Initiatives that expand business continuity management programs to focus on the impacts, connected risk appetite and tolerance levels for disruption of product or service delivery to internal and external stakeholders. | • We ensure all staff understand and follow the Operational Risk Management Framework<br>• We provide training and guidance to first line staff on aspects of the Framework via both the Risk Champions forum and formal training sessions<br>• There are separate policies covering key aspects of the ORMF, including, Managing Corrective Action Plans, RCSA management and Risk Events and Financial losses<br>• Senior Management identify and assess operational risks across their businesses and assess the effectiveness of controls that mitigate those risks using a Risk and Control Self-Assessment (RCSA) process<br>• We have a defined Operational Resilience Policy<br>• We have defined our recovery time and point objectives for our business processes where a sustained operational failure would result in customer detriment<br>• We monitor the operational risk profile alongside proactive recording/ management of events, losses, assurance finding resolutions and incidents |
| Regulatory & Conduct | **Regulatory** – The risk of regulatory or legal sanctions, material financial loss, or loss of reputation as a result of a failure to comply with applicable laws, codes of conduct or standards of good practice<br><br>**Conduct** – The risk that the business strategy, the culture, and the manner in which the business is run, create unfair customer outcomes and detriment to customers and/or undermines market integrity | • We operate a Conduct and Compliance Risk Management Framework supported by a number of policies and procedures that set out how we manage these risks and the minimum standards that we expect<br>• Our Business lines are primarily responsible for the management of these risks, but with strong oversight from the 2nd Line Compliance function<br>• Senior Management identify and assess conduct, compliance and financial crime risks across their businesses and assess the effectiveness of controls that mitigate those risks using a Risk and Control Self-Assessment (RCSA) process<br>• New and emerging regulatory driven changes are overseen through our horizon scanning process<br>• We design our products and services so that they consistently deliver fair outcomes for our customers<br>• We complete regular and themed assurance testing of our activities to ensure that we are operating within our Board approved risk appetite and prevailing legal and regulatory requirements<br>• We operate a programme of staff training and awareness via our regulatory reading programme<br>• We complete money laundering and financial fraud checks on our customers at application stage and during the customer lifecycle |

| Principal Risk | Definition | How we mitigate the risk |
|---|---|---|
| Climate Risk | The threat to HTB Group's business from physical or transition climate risks. | • We monitor exposure to Climate risk and escalate agenda items across the Group's risk committee structure and Board.<br>• We closely monitor Climate Change policy, regulatory guidance and industry advances relating to climate change, considering both transition and physical risks. We assess the impact of these changes/advances on our Business model and risk profile and consider possible impacts on our reporting obligations and our reputation |
| Transversal Risks – Reputational and ESG | **Reputational Risk** – The risk that the Group's people, processes or systems create outcomes that create reputational damage to HTB<br><br>**ESG Risk** – The threat to HTB Group's operations and financial standing as a result of poor Environmental, Social or Governance standards operated across the Group. | • Reputational impact is used to quantify risk and impact<br>• Consideration of reputational risk is embedded within our risk management<br>• We have an ESG steering group in place to oversee the development and embedding of ESG into our day to day risk management and processes<br>• We monitor exposure to ESG risk, including Diversity, Equal Pay and opportunities via HR and escalate agenda items across the Group's risk committee structure and Board<br>• Our People related policies provide guidance to staff to support local social initiatives and charity organisations via volunteering / involvement in local community projects |

## Emerging Risks

The Group recognises the dynamic nature of risk management and follows a structured approach to the identification and monitoring of Emerging Risks that could, in the future, affect the business model. An Emerging risk is an identified risk on the horizon, however, it is not yet clear whether the risk will impact HTB Group or if it does, to what extent it will impact. Each Emerging Risk is allocated to one of four categories:

- **Economic and Political Landscape** – Risks that will emerge directly or indirectly from changes to the National or Global environment in which the Group operates, including those emanating from health or environmental root causes
- **Regulatory Change or Intervention** – Risks that will emerge from National and/or International regulatory bodies that will require material changes to the way in which the Group operates
- **Competitive Landscape** – Risks that will emerge from both traditional operators utilising different operating strategies and/or new entrants to the markets in which the Group operates
- **Technology Risk** – Risks that will emerge from any exploitable weakness in the Group's infrastructure and/or its ability to withstand targeted attacks

Emerging Risks are reviewed at least annually by the Board and regularly by the Board Risk Committee. Regulatory Horizon Scanning is maintained and tracked through monthly management committees.

The HTB Group's main emerging risks comprise of the following.

## Climate Change

Climate change represents a material risk to the Group and the financial system within which it operates. Climate risk arises from both the physical effects of climate change, and from the impact of changes associated with the transition of the economy to a lower carbon economy. Climate risk is increasingly on the Regulatory radar and the guidance / requirements set by the PRA are prescriptive and will impact on the Group's asset funding policies in the short to medium term.

Physical risks could lead to business disruption, damage to assets which could lead to lower property and asset values, lower household wealth and lower corporate profits and litigation.

Transition risks could impact sectors of the economy disproportionately, lead to lower growth and productivity for our customers, leading to increased credit risk and losses.

## Macro-Economic pressures

Macro-economic uncertainty remains high with inflation and the cost of living pressures continuing to escalate. Geo-political tensions in Eastern Europe and the war in Ukraine have impacted energy pricing and has led to a more cautionary consumer and business sentiment.

Uncertainty impacts business and consumer confidence and effects SMEs financial health and investment decisions which can lead to decreased market opportunity (e.g., Asset Finance), as well as depressed profitability which could lead to increased debt service issues. Similarly, the increases observed in energy prices due to the Russian invasion of Ukraine have increased production costs in certain sectors of the economy which could result in margin pressure for companies operating in those sectors.

Companies that have accessed debt funding may be facing increased debt service costs due to the increased interest rate environment, which in turn could lead to increased debt service issues.

Consumers/renters impacted by the cost-of-living crisis may struggle to meet their financial commitments which could impact both repayment profiles and demand within the market. This may have an impact on housing markets should these dynamics deteriorate.

### Competitive Landscape

The current competitive landscape has been impacted as the UK has emerged from the COVID-19 pandemic. The anticipated rebound in the UK economy has not materialised and both consumer and business demand has been impacted. This has been compounded by both the global and local political landscape leading to increased economic uncertainty and rising interest rates.

Secondly, the post pandemic hybrid working model has had an impact on the competitive market in terms of attracting and retaining staff. Market expectations around a flexible approach to working from and outside the office are growing and both new and existing staff decision making is increasingly being influenced by their potential / existing employers' hybrid working policies.

### EPC Rating Requirements

The UK government has indicated that all rented properties will have to achieve an energy efficiency rating (EPC) of C and above by 2028, phased from April 2025 for new tenancies.

If enacted as indicated this requirement would impact available residential rental property supply as landlords comply with the restriction on renting properties that do not meet the minimum efficiency rating, at least in the short term while remediation works are carried out across the rental property sector to meet the minimum standard. Similarly, the Buy to Let Mortgage market would be expected to take account of this in its underwriting standards and reduce mortgage availability for properties that do not meet the minimum threshold or hold an appropriate 'all improvements made' exemption.

Consultation with mortgage providers is ongoing and may result in further delay introducing this requirement. HTB manages this risk via continued horizon scanning of regulatory guidance together with market awareness of current timescales for change and consultation with the regulators.

# ESG overview

## Sustainability

HTB Group is committed to acting in a sustainable and responsible way in respect to all its business operations.

Sustainability encompasses three ESG "Factors" covering a wide range of goals:

- **Environmental** – reducing our impact on global temperature increases, limiting GHG emissions and reducing pollution.
- **Social** – embracing diversity internally and externally and contributing to charitable activity in both the communities we serve and helping disadvantaged communities.
- **Governance** – following good governance practices, including sound management structures, maintaining positive employee relations, fair remuneration for our employees and complying with all laws and regulations.

The Climate Change Steering Committee broadened its scope to become the ESG Steering Group in February and has enabled clearer consideration of all three ESG factors under robust governance.

## Environmental

The Group recognises that Climate Change is a significant strategic risk and a major challenge for the global economy and society. During 2022, the Climate Change risk agenda retained a sharpened focus and climate change risk has continued to be embedded within the wider risk management framework (RMF). Progress has been made in enhancing a risk management framework and oversight of progress against the Board approved plan has been maintained. The Group's response to developing a proportionate approach to Climate Change continues informed by supervisory guidelines and published regulatory feedback.

We closely monitor Climate Change policy, regulatory guidance and industry advances relating to climate change, considering both transition and physical risks. We assess the impact of these changes/advances on our business model and risk profile and consider possible impacts on our reporting obligations and our reputation. We continue to undertake effective horizon scanning to provide early visibility of Climate related financial services issues, including broad alignment with UK Finance activity.

## Social

We monitor exposure to ESG risk, including diversity, equal pay and opportunities via HR and escalate agenda items across the Group's risk committee structure and Board. Our People related policies provide guidance to staff to support local social initiatives and charity organisations via volunteering / involvement in local community projects.

## Governance

The Senior Management Function ("SMF") responsibility for management of climate risk lies with our CRO. Delivery of our Climate Risk management framework is coordinated by the Risk function and progressed in collaboration with colleagues from across the business. To support this oversight and management of climate risk, we have developed and continue to enhance Climate/ESG metrics and KRIs via our risk committee structure, allowing senior management to monitor progress.

ESG, which encompasses Climate Change is a standing Board Committee agenda item. Board Risk Committee discussions this year have included how HTB progressed towards achieving Carbon Neutrality in August and the approach adopted working with our strategic partners, Carbon Footprint. The Board Risk Committee monitors progress against the risk management framework plan where further assessment activity will highlight both physical and transitional risk within existing product portfolios. 2022 saw the first climate change stress test completed as part of the annual ICAAP exercise, focusing on impact of the Bank of England CBES scenario reported on in May.

### Progress made towards our ESG goals in 2022

During 2022 continued progress was made towards HTB's goals and ambitions for ESG:

- HTB Group became certified as a Carbon Neutral organisation in August, working with Carbon Footprint to measure and report our total carbon emissions and offset these by supporting an environmental project to protect the Amazon rainforest in Brazil.
- Board Training was delivered in January focused on providing not only insight into the broader environment pertaining to peers, regulators, and government, but also on how HTB should respond to these challenges to ensure we remain within our strategic parameters of maintaining effective climate change risk management and disclosure commitments.
- Establishment and continued embedding of the ESG Steering Group with senior leader membership to ensure ESG factors such as climate change risk are being suitably managed and to provide challenge to material changes to risk management and the commercial opportunities they represent.
- Business lines are continuing to examine their asset portfolios to better understand their exposure to Physical and Transitional risks over the coming years. Particular attention has focused on physical flood risk and EPC rating coverage across the mortgage portfolio to help Landlords improve their energy efficiency positions of properties in their portfolios.
- Flood risk assessment continued via a post code matching tool laid across the Specialist Mortgage portfolio, including Buy to Let properties. The percentage match of properties with their EPC ratings and linkage to areas of high flood risk potential is increasing. Work on the transitional risk assessment continues concurrently with the review of EPC ratings across the property portfolio feeding the assessment and impacts on properties with a lower than 'C' EPC rating and the opportunities available to help customers or private landlords in this space to improve the efficiency of their properties.
- The 2022 ICAAP round included a Climate Change scenario, covering the potential impacts for HTB if Early, Late or No action at all is taken to achieve a net zero carbon emissions economy by 2050. The results show a relatively benign impact for HTB Group. An additional two scenario's will be completed this year assessing the impact of the physical risk of flooding on the Specialist Mortgage portfolio and the transitional risk of government policy loading carbon taxes on non-climate friendly assets.
- Identification of KRIs / Metrics tracking whether transitional and physical risks are heating or cooling as we progress towards 2030 and beyond. These are continuing to develop in support of the agreed climate change risk appetite statement.
- An Environmental & Sustainability policy has been published covering the HTB Group.
- Climate Change risk continues to be rolled out into the Group's policy framework with relevant, existing polices updated with Climate Risk coverage including physical and transitional risks such as flood and EPC ratings for properties and asset financing now focused on environmentally friendly or sustainable asset funding.

### Risk management

The risks of climate change to the Group are twofold. Firstly, through physical risks associated with changes in climate and weather (such as a greater incidence of storms, floods and sea level rises) and secondly, through the economy's response to climate change and transition to a low carbon economy. These transition risks may be generated through climate-related policy and regulations, technology development and changes in customer sentiment and behaviour. Climate risks, arising through either one or a combination of these channels, cut across the Group's existing risk types – such as credit risk, market risk, operational risk and reputational risk. The Group has updated its risk management framework policy to include Climate risk as a Principal Risk.

Data sources to inform climate change risk KRIs and metrics from both internal and external sources across the portfolio continue to develop and enhance the existing reporting of such metrics.

### Scenario Analysis

Stress test scenarios in the 2022 plan continue to be completed thus informing HTB Group's susceptibility to Climate Change risk focusing on the potential physical and transitional risks the lending.

The Group will continue to build capability and robust data streams to execute scenario analysis.

### Our journey towards the TCFD

The Group plans to enhance the disclosure capability, in even closer alignment with the recommendations of the Taskforce for Climate related Financial Disclosures ("TCFD"). We will share a more advanced summary in our 2023 annual reporting and enhance this year on year, including key metrics beyond our own operational energy consumption and emissions as presented in page 32 of this report.

### Future developments

In 2019, the Bank of England's Prudential Regulation Authority (PRA) issued a Supervisory Statement (SS3/19) that sets expectations for firms regarding their consideration of climate risk across the following four areas: governance arrangements, risk management, stress testing and scenario analysis, and disclosure.

In accordance with SS3/19, several deliverables have been produced and will continue to be built out in 2023. These include:

- Continued refinement of data sources to inform both the Group's current exposure to climate change risk within the portfolio and measurement of progress against the established risk appetite statement.
- Formulation of a Net Zero strategy for the Group building on the work that has been done to achieve carbon neutrality. Additionally, improving understanding of how we measure financed emissions for the assets we finance.
- Expand the breadth and range of ESG/Climate Change metrics and KRIs reported via risk committees to the Board.

## Energy and Carbon Reporting

Streamlined Energy and Carbon Reporting ("SECR") requirements came into place for all unquoted large companies for periods beginning on or after 1 April 2019. These requirements are intended to complement Task Force on Climate-related Financial Disclosures ("TCFD") disclosures.

In accordance with the Greenhouse Gas ("GHG") Protocol framework, we have calculated the GHG emissions associated with our Scope 1, 2 and 3 as follows:

- **Scope 1:** includes emissions from activities under the Group's control i.e. fuel combustion on site
- **Scope 2:** includes emissions from consumption of purchased electricity, heat, steam and cooling.
- **Scope 3:** business travel not owned or controlled by the Group.

In 2022, our total GHG emissions were 214.6 tonnes of carbon dioxide equivalent ("tCO2e"), equating to 0.56 tCO2e per employee. The increase in our tCO2e overall is as a result of acquiring WBL and 3 additional offices (Birmingham, Northwich, New Malden). We also engaged with an external environmental consultancy to help calculate our GHG emissions. Given the ending of lockdown restrictions in 2022 our office based consumption has increased as well as our business travel. Our Scope 3 emissions from business travel is the largest source of GHG emissions. In 2022, we have included Site Gas from the 3 WBL sites that we operate from based on the leases in place.

A full breakdown of our annual GHG emissions and energy consumption, together with corresponding data for 2021, is shown in the table below.

| Scope | Source | 2022 | 2021 |
|---|---|---|---|
| **Scope 1 (Direct emission)** | Activities for which the Group is responsible for gas combustion or fuel consumption for transport (in tonnes of carbon dioxide*) | 50.77 | - |
| | Activities for which the Group is responsible for gas combustion or fuel consumption for transport (in kWh) | 278,155 | - |
| **Scope 2 (Indirect emission)** | Consumption of purchased electricity** (in tonnes of carbon dioxide) | 63.21 | 45.14 |
| | Consumption of purchased electricity (in kWh) | 326,853 | 212,590 |
| **Scope 3 (Other indirect emission)** | Emissions from business travel/transport (in tonnes of carbon dioxide) | 100.73 | 45.88 |
| | Emissions from business travel/transport (in kWh) | 425,565 | 216,079 |
| **Total** | Total energy usage (kWh) | **1,030,573** | **428,669** |

The Group is focused on its transition to net zero to comply with a zero-carbon economy by 2050 and has an ESG Framework in place to manage this. Through this framework, the Group will formalise its road to net zero and with corresponding actions to reduce emissions going forward and establish a net-zero target date.

* Carbon dioxide values above are calculated based on the Department of Business, Energy and Industrial Strategy guidelines published in August 2019.
** Electricity usage are based on consumption recorded on purchase invoices.
Vehicle fuel usage is based upon expense claims and recorded mileage.

## Corporate Governance

This section of the strategic report describes how the Directors have had regard to the matters set out in section 172 (1) (a) to (f) of the Companies Act 2006 when performing their duty.

Section 172 of the Companies Act 2006 requires a Director of a company to act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing this, section 172 requires a Director to have regard, among other matters, to: the likely consequences of any decision in the long term; the interests of the company's employees; the need to foster the company's business relationships with suppliers, customers and others; the impact of the company's operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct; and, the need to act fairly with members of the company.

The Directors have given careful consideration to the factors set out above in discharging their duties under section 172 with respect to the Bank's stakeholders and its reputation. From a Group perspective, Wesleyan Bank is a separately regulated bank that has an independent board with primary responsibility for S172 matters within Wesleyan Bank however, being part of the Group, the Directors maintain close oversight of the activities of Wesleyan Bank and take a wholistic approach to section 172 and apply a Group lens:

- ***Customers*** – The Board recognises that building a sustainable and enduring business franchise is dependent on providing products and service levels that meet the needs and expectations of the Group's customers. Across the Group's various specialist lending businesses, customers include professional landlords, property developers, and SME and Corporate borrowers. Across the Savings and Deposits business, customers are the Retail, SME and Corporate customers placing deposits with us. The Board seeks to ensure that the key priority of positive customer outcomes is embedded in the way the Group conducts its business. Specifically, the Board places great emphasis on the development of strong relationships with customers built on trust and that customers benefit from products that are straightforward, fit for purpose and reflect their particular needs. The Board has ensured that the Group has had regard to the views of its customers by collecting feedback to understand what customers think of the Group's products and service levels and whether they are meeting their needs and expectations.

  In 2022, the Group has continued to build on its customer experience program in order to enhance customer and broker engagement, which included the recruitment of additional staff focused on delivering the customer experience program as well as engaging independent third party suppliers to obtain independent feedback from customers and brokers and to assist the Group in analysing that feedback. The Board recognises that a greater understanding of the Group's customers, their needs and their priorities ensures the Group is equipped to deliver continuous improvement across its processes, procedures, communication and products.

- ***Employees*** – Employees are fundamental to the delivery of the Group's strategy as a specialist bank. The Board wants the Group's employees to have challenging and fulfilling careers in a values orientated culture. As the Group continues to build its franchise, the Board is committed to attracting talented people and investing in them.

  Employee information, supported by a dashboard and metrics, is a standing item of the CEO's board report and has been a key focus for Board discussions in 2022.

  The Group has sought to increase gender diversity within the Bank. This has been done by using a range of tools supporting merit-based recruitment while encouraging diverse candidate pools and working with external recruitment partners who have a focus on diversity. The Bank's commercial area has a diverse leadership team where approximately 40% of the most senior roles are female.
  In addition, the Group has focused on the development of female leaders and to promote a more diverse talent pool for future leadership roles. There was a significant participation in the Group's 'Women in Leadership' programme started in 2021, an external programme leading to a management qualification.

The Group monitors exposure to ESG risk, including diversity, equal pay and gender pay gap and it is closely monitored across the Group's risk committee structure and Board. The Bank has recently grown in size (to exceed 250 FTE) and will commence Gender Pay Gap reporting in Q1 2023. Policies and benefits are regularly reviewed to ensure they support the Group's goal of greater gender balance and embedding diversity and inclusion.

Following the pandemic and a return to work the Group operates a more flexible working environment and recent activities to support staff have focused own wellbeing, mental health and financial wellbeing initiatives. This is in addition to launching a more focused approach to charitable giving/volunteering and support. During 2022, the CEO and the Group Executive Committee have regularly communicated with employees on key financial, strategic and operational matters via email, video updates and Q&A sessions.
A staff 'Pulse Survey' was carried out to enable the executive and the board to understand the views of staff across a range of topics, including the Bank and communication, enablement and empowerment, and internal communication and this has helped inform areas of target for improving the employee value proposition.

The CEO launched the 'Let's Talk' initiative in which staff could participate, on a voluntary basis, in small informal group discussions directly with the CEO to discuss their views on a range of topic covering:

- Strategy
- Vision and values
- Reward, recognition and remuneration
- Objective setting and performance management
- Communication
- Work / life balance and working styles
- Personal development and career planning
- Good ideas

In the context of the run-off, the Board is, and has since the acquisition been, very focused on ensuring that it retains the right employees through a combination of financial incentives, career progression opportunities and working environment. Weekly announcements were implemented of internal vacancies and promotion opportunities to encourage WBL's staff to seek permanent roles within HTB.

HR matters are overseen from a Group perspective but to ensure that there was the right focus on the needs of the WBL's staff, there was the appointment of an HR Business Partner solely dedicated to the WBL's staff and their changing needs and regular visibility and engagement across all sites.

- ***Regulators*** – The Group operates in highly regulated market, and as such is subject to the regulation of both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). The Board has an intense focus on its own responsibilities and those of the relevant Senior Management Function ("SMF") responsibility holders. The Board is also focused on ensuring that the Group embeds high standards of conduct into its product design, service delivery and culture, as well as considering correspondence and publications from the regulatory sphere which may have an impact on this. The Board seeks to maintain an open and active dialogue with the Group's regulators and the acquisition of Wesleyan Bank has seen an increase in engagement.

- ***Brokers*** – Brokers are a key source of business for the Group and, as such, are vital to the success of the Group. The Group undertakes regular and frequent engagement with Brokers to understand their views on the Group's products and service levels.

  This regular contact allows Brokers to discuss new and existing business proposals as well as maintaining and developing the relationship and their knowledge of the Group's products and service. Road shows and networking events are undertaken with Brokers to promote the Group's products and provide training on its criteria and processes.

In this regard the Group understands that Brokers, (1) want products that meet the needs of their customers, (2) want clarity of lending criteria so they are confident that they are placing business with the right funders, (3) want the ability to discuss their customer's requirements with experts and clear information on the progress of the transactions they introduce, and (4) want speed of delivery and processes that make the process easy.

The Group's business development managers listen and work with Brokers, making themselves available to discuss cases and helping to obtain swift and reliable decisions for customers.

- ***Shareholders*** – The Group's shareholders are critical to the success of the Group as the providers of capital to underpin the growth and development of the business and to input into the strategy of the Group. Representatives of the Group's shareholders have seats on the Board and attend all Board meetings, ensuring they are kept up-to-date on the performance of the Group. The shareholders are fully engaged with the key performance metrics provided (including capital, profitability and return on equity) and are pivotal in reviewing and challenging the Group's annual Corporate Plan and strategy. The Board maintains a close working relationship with the shareholders' representatives centred on the development and execution of the Group's strategy.
- ***Community and Environment*** – Towards the end of 2021, the Group implemented an internal Climate Change Steering Group and during 2022 that steering group broadened its remit to encompass oversight of ESG matters more generally and ensures reporting of ESG matters to the Board. The steering group formulated a comprehensive Environmental and Sustainability policy which was approved by the Board and has been rolled out across the Group.

  In August 2022, the Group achieved carbon neutrality. This is an important milestone on the Group's road to net-zero.

  In October 2022, the Group implemented Neighbourly, an award-winning platform that connects good causes with businesses and helps those businesses make a positive impact in their communities by donating volunteer time and money. The Group's staff are given additional paid leave by the Group and encouraged to participate in good causes that positively impact the community. The uptake has been very positive with both individuals and teams within the Group taking part in volunteering days that positively impact the community.
- ***Suppliers*** – The Group's business is supported by a number of suppliers and as the business continues to grow, the Group has seen this network expand. As part of the Group's operational resiliency activity, the Group has been enhancing internal controls regarding how the Group sources and manages its supplier relationships. An Annual Service Review also takes place every 12 months, and more often where appropriate, with results documented to monitor and ensure a high standard of service is continuing to be received. The Group's supplier on boarding process includes a rigorous risk assessment, financial checks, due diligence on data and security controls as well as human rights policies.

  The Board recognises that the Group's suppliers are a key part of the service the Group provides to its customers and are committed to treating them fairly on payments.

  The need to foster sustainable business relationships with suppliers is also addressed by obtaining confirmations from suppliers relating to compliance with modern slavery, bribery and corruption laws and the Board has overseen the approval and implementation of the Group's Modern Slavery Statement and its own Anti-Bribery and Corruption Policy.

- ***Reputation*** – The desirability for the Group to maintain a reputation for high standards of business conduct is a core focus of the Board. The Board has approved and overseen the implementation across the Group of its statement of Vision, Values and Culture which all underpin a desire for high standards of business conduct. The Group's stated Mission is to deliver positive customer outcomes, rewarding careers and greater shareholder value through a high-performing culture grounded in excellence and integrity. This is supported by a proposition of being open, responsive, consistent, clear, trustworthy, expert, pragmatic, flexible and innovative and is further supported by behaviours including, for example, an expectation that the Group's staff will approach everything they do with discipline and set high standards.

  As set out above, in 2022 the Group has continued to build out its dedicated customer experience program in order to enhance customer and broker engagement, which included engaging independent third party suppliers to obtain independent feedback from customers and brokers. One of the key objectives of this is to ensure that the Board can monitor and ensure that the feedback from its customers and brokers is consistent with maintaining a reputation for high standards of business conduct. The Group's franchise strength is evidenced by the fact that HTB's Savings business won the Business Moneyfacts Award for the 6th time in row in 2022 whilst HTB's Specialist Mortgages business won for the third time in a row in 2022.

The Strategic Report has been reviewed and approved by the Board and signed on its behalf by:

**Timothy Blackwell**

Chief Financial Officer

27 July 2023

# 2 Governance Framework

# Governance Framework

## The Wates Corporate Governance Principles

The Group has applied the Wates Corporate Governance Principles for Large Private Companies (the "Wates Principles") published by the Financial Reporting Council in 2018, with Wesleyan Bank adopting the Wates Principles following its acquisition by the Bank. Applying the Wates Principles has ensured that the Group has continued to enhance its corporate governance standards for the benefit of all its stakeholders; ensuring that it is well managed and aligned behind a clear purpose. The table below sets out how the Group has complied with all six Wates Principles in 2022.

| Principle | Explanation of how it is applied |
|---|---|
| **Purpose and Leadership** – an effective board develops and promotes the purpose of a company and ensures that its values, strategy and culture align with that purpose | • Primary role of the Board is to provide leadership and set direction on the Group's purpose, values, strategy and culture<br>• The Board delegates the day-to-day responsibility for the implementation of the strategy, development of the culture and the management of the Group to the Chief Executive who is supported by the Group Executive Committee<br>• The Board monitors and challenges delivery by the Chief Executive through appropriate reporting<br>• In 2022, the Board and the Group Executive Committee continued to build upon its Specialist Bank proposition of being 'the go-to bank in our chosen markets' and 'Excellence through Specialism'. This means that the Group will carefully select its chosen markets and ensure that it becomes the first choice for its brokers and customers by being open, responsive, consistent, clear, trustworthy, expert, pragmatic, flexible and innovative<br>• The vision, proposition, values and expected behaviours have been communicated from the Board, through the Chief Executive Officer and the Group Executive Committee throughout the organisation. They are embedded in the Group's decision-making processes, the way that the Group conducts its business and engages with its customers and other stakeholders. They are built into staff objectives and staff performance is assessed against achievement of objectives aligned to values |
| **Board Composition** - effective board composition requires an effective Chair and a balance of skills, backgrounds, experience and knowledge, with individual directors having sufficient capacity to make a valuable contribution. The size of a board should be guided by the scale and complexity of the company | • The Board consists of four Independent Non-Executive Directors (including the Chairman), two Shareholder Non-Executive Directors and two Executive Directors<br>• The Board has a separate Chairman and Chief Executive Officer<br>• The Board has an appropriate mix of Executive and Non-Executive Directors, who have the requisite skills, knowledge, experience and understanding of the Group's business and of banking more generally. The Non-Executive Directors bring a wealth of outside experience across a broad range of areas, including audit, finance, banking, risk, strategy, technology, operations, communications and brand<br>• The Nomination and Remuneration Committee is responsible for all senior appointments including all Board Directors and the Group's senior management<br>• The Nomination and Remuneration Committee also considers both senior management and Board succession plans at least annually<br>• The effectiveness of the Board and its Committees is formally evaluated on an annual basis. The assessments are undertaken internally and then every third or fourth year external consultants are employed to bring independent challenge to the assessment process and to carry out an independent assessment<br>• In 2022, the effectiveness review was carried out by way of an internal self-assessment questionnaire completed by each Board member followed by review meetings between the Chairman and each Board member. The effectiveness review sought to establish the effectiveness of the Board as a committee as well as the effectiveness of individual Board members. The evaluation covered the Board agenda, composition and competence, culture and behaviours, process, the Chairman and the effectiveness of each of the Boards committee. This assessment concluded that the Board and each of its individual directors have been effective over the year |

| Principle | Explanation of how it is applied |
| --- | --- |
| **Board Responsibilities** - the board and individual directors should have a clear understanding of their accountability and responsibilities. The board's policies and procedures should support effective decision-making and independent challenge | • The Board is chaired by an independent Non-Executive Chairman who ensures that there is effective input, appropriate balance of views from Executive and Non-Executive Directors and constructive debate, challenge and structure in the decision-making process<br>• The Group operates within a robust set of governance and risk management frameworks, including clear and detailed Terms of Reference for the Board and each of its Committees. The Board and Committee Terms of Reference are reviewed annually<br>• The Board has delegated certain responsibilities to a Risk Committee, an Audit Committee, a Nominations and Remuneration Committee and the Chief Executive. Each of these Committees reports back to the Board on matters considered, and decisions made, by those Committees and considers any matters escalated by those Committees. The role and responsibilities of the Board and its Committees are set out in more detail on pages 41-44 of the Corporate Governance section of this Report<br>• The Board receives regular reports on business, financial performance, employee engagement, stakeholders and material risks affecting the business. The Board considers whether systems and controls are operating effectively, and that the quality and integrity of information provided to it is reliable through the assurance actioned within the three lines of defence model<br>• The Board met 10 times during the year, however as a result of the acquisition of Wesleyan Bank a sub-Committee of the Board met a further 2 times in 2022. Further details on key matters discussed in those meetings are provided in pages 41-44 |
| **Opportunity and Risk** - a board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value and establishing oversight for the identification and mitigation of risks | • The Board seeks opportunity for growing existing business lines as well as opportunities for adding additional complimentary business lines which are aligned with its Specialist Bank proposition (described above). The Strategic Report (pages 4-36) provides details of how the Group creates and preserves long term value including future growth opportunities<br>• The Board's Risk Committee is delegated with responsibility for the oversight of the Group's current and future risks and the performance of the Group against its approved risk appetite through information reported through the Group's Risk Management Framework. The Risk Management section of this Report provides detailed information on the framework set by the Board Risk Committee for the management of the Group's risks<br>• The Board's Risk Committee is responsible for the Group's Risk Management Framework, its development, its ongoing effective operation, periodic review of its appropriateness and any required calibration to it<br>• During 2022, the Board Risk Committee met 9 times. Further details on key matters discussed in those meetings are provided in pages 41-44. |

| Principle | Explanation of how it is applied |
|---|---|
| **Remuneration** - a board should promote executive remuneration structures aligned to the long-term sustainable success of a company, taking into account pay and conditions elsewhere in the company | • Remuneration policies and practices - designed to support strategy and promote long-term sustainable success, with the role of the Nomination and Remuneration Committee to set and oversee the implementation of the Group's remuneration policy and processes, including those for the Group's Executive Directors and other members of its senior management<br>• The Nomination and Remuneration Committee has clearly defined Terms of Reference and reviews remuneration matters (including remuneration policy), employee benefits and performance related pay structures for the Group<br>• During 2022, the Nomination and Remuneration Committee met 7 times. Further details on key matters discussed in those meetings are provided in pages 41-44 |
| **Stakeholder Relationships and Engagement** - directors should foster effective stakeholder relationships aligned to the company's purpose. The board is responsible for overseeing meaningful engagement with stakeholders, including the workforce, and having regard to their views when taking decisions | • The Group's key stakeholders include customers, regulators, employees, shareholders, brokers and suppliers<br>• The Group's explicit mission, set out in its Vision, Values and Culture statement, is to deliver positive customer outcomes, rewarding careers and great shareholder value through a high-performing culture grounded in excellence and integrity. The set of expected behaviours underpinning the Group Vision, Values and Culture are all aligned to supporting Stakeholder relationships<br>• The Section 172(1) statement on pages 33-36 provides further details of how the Board has developed various engagement mechanisms in order to foster effective relationships with all its key stakeholders and to balance their interests in its decision making |

## Structure of the Board and Board Committees

The Group is committed to the highest standards of corporate governance and its governance framework is therefore structured to achieve responsibility, accountability, transparency, and fairness.

There is an overarching Group Governance Framework which ensures that there is both an appropriate degree of independence for Wesleyan Bank as well as effective group oversight and strategic leadership of the Group by HTB.

Each of HTB and Wesleyan Bank have their own Board. Each Board is supported by a number of Committees to which the Board has delegated relevant authority; the principal Committees being the Board Risk Committee, the Audit Committee, and the Nomination and Remuneration Committee.

Each Board is comprised of an independent Non-Executive Chairman, Non-Executive (Shareholder) Directors, independent Non-Executive Directors and Executive Directors. Two of the Executive Directors and one of the Non-Executive Directors of HTB are also, respectively, Executive Directors and the Non-Executive Chairman of Wesleyan Bank.

The HTB Board approves the strategy and direction of the Group, sets the policies and risk appetite, monitors risk management, financial performance and reporting, and ensures that appropriate and effective succession-planning arrangements and remuneration policies are in place. Directors are appointed by the Board. Non-Executive Director Appointments can be terminated at any time, without notice or payment of compensation for loss of office.

HTB Board meetings are held normally ten times a year although two additional Board Sub-Committee meetings were held in 2022 in relation to the acquisition of Wesleyan Bank. This enables Directors to regularly review corporate strategy, the operations and the results of the business and to discharge their duties within a framework of prudent and effective controls.

Each Board is supported by its Committees, which make recommendations to the Board on those matters delegated to them. These Committees comprise only Non-Executive Directors and each is chaired by an independent Non-Executive Director. Matters such as internal and external audit, risk, financial reporting, governance and remuneration policies are delegated to these Committees in order that the Board can spend a greater proportion of its time on strategic items.

The Committee Chairs report to the Board at the Board meeting following each Committee meeting on the activities of their respective Committees. The Board Chairman undertakes an annual review of performance of each Director. The Board Chairman's performance is evaluated by the Non-Executive Directors taking account of the views of the Executive Directors.

The Chairman of the Wesleyan Bank Board engages with the HTB Board (representing HTB as shareholder of WBL) following each Wesleyan Bank Board meeting in accordance with the Wesleyan Bank Board Terms of Reference to inform HTB on Wesleyan Bank's performance against strategy and to understand HTB's views on governance and performance against the strategy.

The Terms of Reference provide that a designated member of each Wesleyan Bank Board Committee (Audit, Risk and Nomination and Remuneration) should meet with the respective HTB Board Committee (representing HTB as shareholder of WBL) following each Committee meeting in accordance with that Committee's Terms of Reference on significant matters related to their areas of responsibility and, in practice, the purpose of this requirement is achieved by virtue of the overlapping directorships and overlapping senior management / SMF functions in attendance at all meetings.

## Role of Chairman and Chief Executive Officer

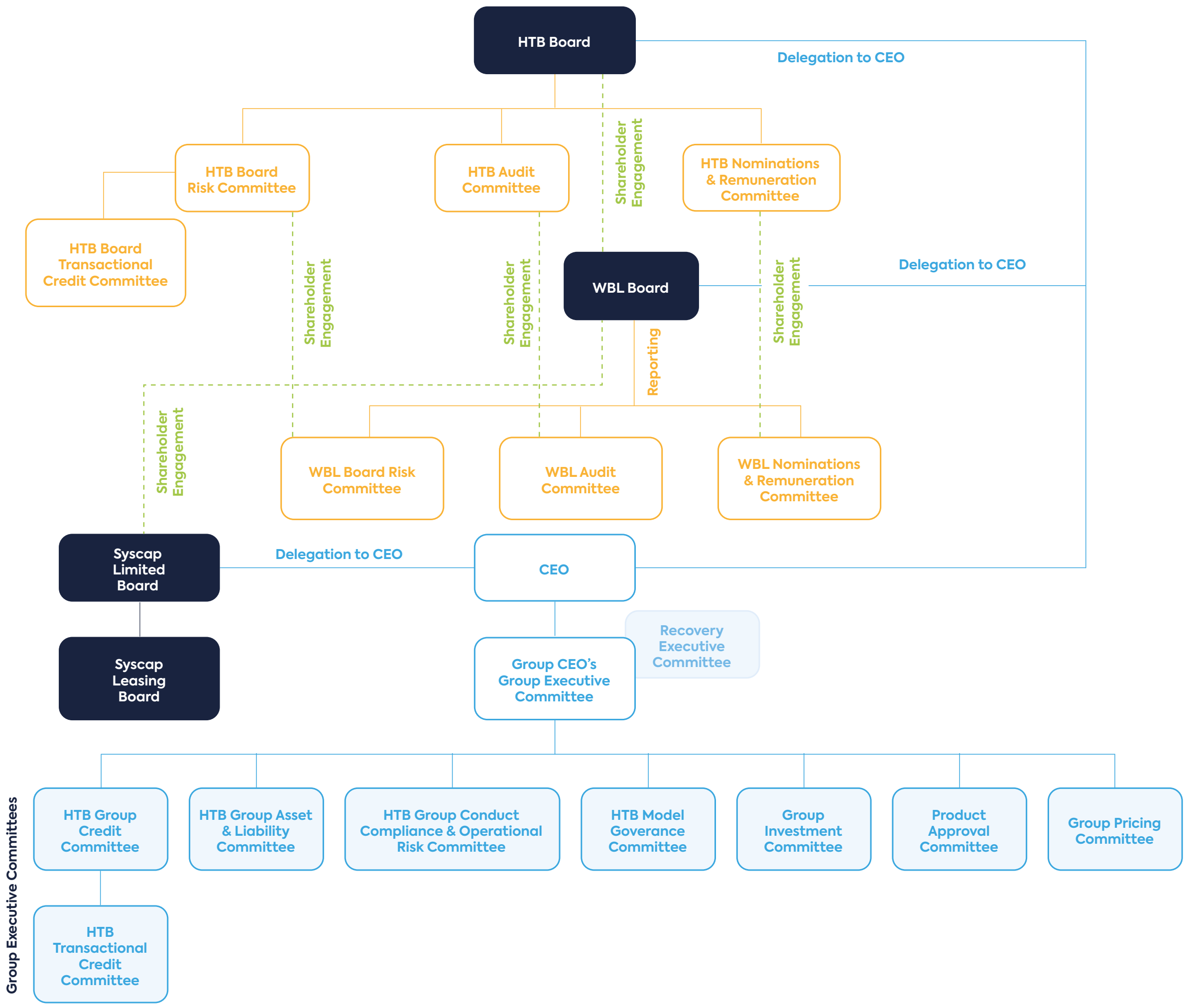
There is a clear division of responsibilities between the Chairman and the Chief Executive Officer. The Chairman has overall responsibility for the leadership of the Board, its effectiveness on all aspects of its role and setting its agenda. The Chief Executive Officer is responsible for the day to day running of the business and is accountable to the Board for its operational and financial performance.

## Compliance with the Senior Managers Regime

The PRA defines a set of prescribed responsibilities ("Responsibilities"), which must be allocated to a senior manager performing a Senior Management Function. The Group maintains a Senior Management Functions (SMF) Responsibilities Map and a list of SMF Responsibilities which are contained within the documents making up the Corporate Governance Framework. The Board and Committees have their own detailed terms of references which outline their responsibilities and delegations within the Group.

## Structure of the Group's Boards and Committees

Details of HTB Board and Committees are shown below. Board Membership and overview of subsidiary Boards and Committees are contained within their respective Annual Reports.




HTB provides WBL and its subsidiaries with outsourced services through these committees as set out in the Intra-Group Services Agreement ("IGSA") and the Terms of Referance for these Committees. WBL and its subsidiaries exercise oversight through the receipt of reports / escalation from each of these committees to the relevant WBL Risk / Audit Committee.

**Membership**

**Directors**

Executive Directors & Senior Management

Executive Directors, Senior Managers & Nominated Staff Members

## HTB Board and Committee membership attendance record

| Board Member | Board | Risk Co | Audit Co | Nom/Rem Co |
|---|---|---|---|---|
| Robert Sharpe | 10 | | | 7 |
| Timothy Blackwell | 10 | | | |
| Robert East (resigned on 30 June 2022) | 5 | 4 | 4 | 4 |
| Astrid Grey (resigned on 30 June 2022) | 5 | 4 | | 3 |
| Richard Price | 10 | 9 | 6 | 7 |
| Martyn Scrivens | 10 | 9 | 6 | 6 |
| Dominic Slade | 8 | | | 7 |
| Richard Sommers (appointed on 1 June 2022) | 5 | 4 | 3 | 3 |
| Julia Warrack (appointed on 1 July 2022) | 3 | 2 | | 2 |
| Matthew Wyles | 10 | | | |
| **Meeting Total** | **10** | **9** | **6** | **7** |

The key Board and Management Committees are as follows.

### Audit Committee

The HTB Audit Committee oversees the effectiveness of the Bank's internal control environment, monitors the integrity of the financial statements and risk management systems, involving internal and external auditors in that process, and considers compliance monitoring programmes. It focuses in particular on compliance with accounting policies and ensuring that an effective system of internal control is maintained as well as overseeing and monitoring whistle blowing. The Committee recommends to the Board the appointment of both internal and external auditors and approves the annual internal and external audit plans. The Committee also oversees the Model Governance Committee which operates under its own terms of reference. The Committee is chaired by an independent Non-executive Director and comprises solely Non-Executive Directors. The Wesleyan Bank Audit Committee performs the same role for Wesleyan Bank, having regard to Group policies and objectives, but with a focus on Wesleyan Bank.

### Board Risk Committee

The HTB Board has delegated responsibility for oversight of the Group's principal risks to the Board Risk Committee. This involves reviewing, challenging and recommending to the Board, the aggregate risk profile of the Group, including performance against risk appetite for all risk types and ensuring both the risk profile and the risk appetite remain appropriate. This Committee oversees the development, implementation and maintenance of the Group's Risk Management Framework, compliance with relevant regulations and law and proper functioning of controls over the prevention of money laundering, bribery and fraud. It considers and recommends to the Board the ILAAP, ICAAP, Funding Plan, Recovery Plan, Resolution Pack and Capital Management Plan. The Committee also oversees ALCO, Credit Committee and Conduct, Compliance & Operational Risk Committee which operate under their own terms of reference. The Committee is chaired by an independent Non-Executive Director and comprises independent and shareholder appointed Non-Executive Directors. The Wesleyan Bank Risk Committee performs the same role for Wesleyan Bank but with a focus on the principal risks facing Wesleyan Bank but having regard to any potential Group impact.

### Nomination and Remuneration Committee

The HTB Nomination and Remuneration Committee reviews remuneration matters (including remuneration policy), employee benefits, performance related pay structures for the Group and leads the process for identifying and making nomination recommendations to the Board. It is also responsible for considering all senior appointments at Executive levels (including Non-Executive Directors). It reviews and approves succession plans for all Board and Board Committee positions (including the Group Executive Committee); makes appointments of Committee Approved staff under recommendation from the CEO; sets remuneration and benefits entitlements of Committee-Approved staff; and, agrees bonus awards for the Group and Committee-Approved staff. The Committee is chaired by the Chairman of the Board and comprises independent and shareholder-appointed Non-Executive Directors. The Wesleyan Bank Nomination and Remuneration Committee performs the same role for Wesleyan Bank, having regard to Group policies and objectives, but with a focus on Wesleyan Bank.

### Group Executive Committee

The Board delegates day-to-day responsibility for the running of the business to the Chief Executive. The Chief Executive is Chief Executive for both HTB and Wesleyan Bank and has constituted the Group Executive Committee to support him in the discharge of his responsibilities, including proposing strategy to the respective Boards, and for delivering the strategy as approved by Boards. The Group Executive Committee is supported by a number of sub-committees as set out in the structure chart above.

## HTB Board

### Board

**Robert Sharpe, Independent Non-Executive Director and Chairman**

SMF 9: Chair of the Governing Body & SMF 12: Chair of the Remuneration Committee

Robert has a wealth of experience in the retail banking sector. In addition to HTB, Robert is currently Chairman of Metro Bank PLC and has previously held a number of non-executive board positions in the UK (and the Middle East) since retiring as an Executive Director at companies including Bank of Ireland UK PLC, Vaultex Limited (a JV between HSBC and Barclays), Aldermore Bank PLC, Barclays Pension Trustees Limited, LSL Properties PLC and George Wimpey PLC. Robert's previous executive roles include Chief Executive Officer of Portman Building Society and subsequently West Bromwich Building Society.

**Richard Sommers, Independent Non-Executive Director**

SMF 10: Chair of the Risk Committee

In addition to HTB Board, Richard sits on the Board of Bank of Ireland (UK) PLC, where he chairs the Risk Committee and is a member of the Audit Committee. Richard's past non-executive director roles include Al Rayan Bank, where he chaired the Risk Committee; and West Bromwich Building Society, where he chaired the Risk Committee. Richard was also Chair of the Audit and Risk Committee at the University of York. During a 30-year executive career in financial services, Richard held the roles of Finance Director and then Risk Director for Barclays' Retail Financial Services Division; Finance Director, Barclaycard; and Chief Financial Officer for Barclaycard USA.

**Julia Warrack, Independent Non-Executive Director**

FCA CF

With over 23 years of experience across a number of senior technology and transformation roles, Julia brings a wealth of knowledge gained across 9 industry sectors, including public sector, to help HTB define and deliver a strategy for growth. Julia has championed technology and innovation for the vast majority of her career, encouraging teams to challenge the orthodoxy and dare to be different. An exponent of collaboration and modern agile practices, Julia's appointment will help HTB by bringing her extensive and cross sector expertise and passion for technology and innovation to bear across the business.

**Martyn Scrivens, Non-Executive Director**

HTB: SMF 11: Chair of the Audit Committee

Wesleyan Bank: SMF 9: Chair of the Governing Body & SMF 12: Chair of the Remuneration Committee

Martyn's career in audit, risk management and governance spans four decades, including operating at Board level in both the private and public sector. Martyn spent five years at Credit Suisse Group where he was Global Head of Internal Audit and prior to that he oversaw group audit functions at Lloyds Banking Group as Group Audit Director for nine years. Before joining Lloyds, Martyn spent 24 years at international professional services firm Arthur Andersen in the UK, Switzerland and Australia. Martyn also serves as Chairman of Wesleyan Bank and Yeovil District Hospital NHS Foundation Trust, and Non-Executive Director at Somerset NHS Foundation Trust and Ardonagh Group. He is a Fellow of the Institute of Chartered Accountants, where he chaired the Institute's Internal Audit Advisory Panel for 10 years.

**Dominic Slade, Non-Executive Director**

FCA CF

Dominic is a Non-Executive Director and is also the Managing Partner of Alchemy. Dominic joined Alchemy in 1998, became a Partner in 2001 and was elected Managing Partner in 2009. Previously in investment banking at UBS, Dominic has a degree in Social & Political Sciences, an MPhil in International Relations from Cambridge and an MBA from Harvard.

**Richard Price, Non-Executive Director**

FCA CF

Richard is a Non-Executive Director on the board of HTB. Richard spent the majority of his career with KPMG where he was a partner from January 1997 to July 2012. He is currently also a Non-Executive Director of Brooks Macdonald Group PLC. Richard holds a B.Sc. in Economics and Business Economics from the University of Southampton and is a Chartered Accountant.

## Board

**Matthew Wyles, Chief Executive Officer ("CEO")**

HTB and Wesleyan Bank: SMF 1: Chief Executive

Matthew was appointed as CEO with effect from 23 April 2018. Prior to joining HTB, Matthew was an Executive Director of Castle Trust Capital PLC. From 2007 to 2012, Matthew served as an Executive Director of Nationwide Building Society, latterly as Group Distribution Director where his responsibilities included the branch network, contact centres, Nationwide Financial Solutions and the group's operations in the intermediary mortgage market. Matthew was the Chairman of the Council of Mortgage Lenders for two years running in 2009 and 2010.

**Tim Blackwell, Chief Financial Officer ("CFO")**

HTB and Wesleyan Bank: SMF 2: Chief Finance

Tim has over 26 years' experience in financial services. Most recently, he was IPO Director for the CYBG float following a similar role for TSB. Prior to that he undertook various roles in LBG Group Finance as Group Financial Controller and BP&A Director and as FD of Asset Finance Divisions. Prior to joining LBG, Tim spent many years in big four accountancy firms providing transaction advisory services to a wide range of FS businesses.

# 3 Directors' Report

# Directors' Report

The Directors present their report and financial statements for the year ended 31 December 2022.

The Strategic Report set out on pages 4-36 of this Annual Report includes information that would otherwise need to be included in this Directors' Report

## Principal Activities

Hampshire Trust Bank PLC ("the Bank") is a UK Bank, authorised by the Prudential Regulation Authority (PRA) and regulated by both the PRA and the Financial Conduct Authority (FCA). The Bank provides bank finance to small and medium sized enterprises in the UK secured against property and business assets, including vehicles. It also provides retail savings products to private individuals and SMEs. The principal activities of subsidiaries of the Bank are listed in note 40.

## Business Review and Future Developments

Information regarding the business review and future developments (page 32), key performance indicators (page 4) and principal risks (pages 23-26) is contained in the Strategic report.

## Results for the year

The Bank made a profit before tax on continuing activities of £64.5m (2021: £27.3m), and a profit after tax of £54m (2021: £20.5m). The Group made a profit before tax on continuing activities of £88.4m, and a profit after tax of £78.1m.

## Proposed Dividend

The Directors do not recommend the payment of a dividend (2021: £nil).

## Business relationships

We have appropriately considered the relevant interests of the various stakeholders as mentioned in pages 33-36 in our Board discussions and decision making during the year ended 31 December 2022.

## Greenhouse gas emissions

Information on the Group's energy consumption is set out on page 32 of the Strategic Report.

## Corporate governance arrangements

The Bank has applied the Wates Corporate Governance Principles for Large Private Companies. There is no obligation on companies to adopt these principles, but the intention is that the Wates Principles provide an approach to corporate governance that offers sufficient flexibility without being too prescriptive.

The Wates Principles are a set of six high level principles of corporate governance. It is a voluntary framework which adopts the "apply and explain" approach. Further details in pages 37-40 of the Corporate Governance section.

## Financial Instruments

The Group uses financial instruments to manage certain types of risk, including interest rate risk. Details of the objectives and risk management of these instruments are contained in pages 23-26 of the risk management section. Details of financial instruments can be found in notes 21 and 22 to the financial statements.

## Employee Share Scheme rights

Details of how rights of shares in employee share schemes are exercised are provided in note 7.5 to the financial statements.

## Employees

The Group is committed to employment policies, which follow best practice, based on equal opportunities for all employees, irrespective of gender, race, colour, age, disability, sexual orientation or marital or civil partner status. The Group is committed to ensuring that disabled people are afforded equality of opportunity with respect to entering and continuing employment with the Group. This includes all stages from recruitment and selection, terms and conditions of employment, access to training and career development.

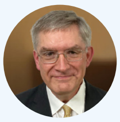
Information on employee involvement and engagement can be found in page 33-34 of the Corporate Governance section.

## Appointment and retirement of Directors

The appointment and retirement of the Directors is governed by the Bank's Articles of Association and the Companies Act 2006. The Bank's Articles of Association may only be amended by a special resolution passed by shareholders at a general meeting.

## Board Composition

The directors who held office during the year and at the date of this report were as follows:

| | | |
|---|---|---|
|  | **Robert Sharpe** (Chairman) | Independent Non-Executive Director. Chairman of the Board, and Chairman of the Nomination and Remuneration Committee |
|  | **Martyn Scrivens** | Independent Non-Executive Director and Chairman of the Audit Committee |
|  | **Robert East** (Resigned on 30 June 2022) | Independent Non-Executive Director, Chairman of the Board Risk Committee and Chairman of the Board Transactional Credit Committee |
|  | **Richard Sommers** (Appointed on 1 June 2022) | Independent Non-Executive Director, Chairman of the Board Risk Committee and Chairman of the Board Transactional Credit Committee |
|  | **Astrid Grey** (Resigned on 30 June 2022) | Independent Non-Executive Director |
|  | **Julia Warrack** (Appointed on 1 July 2022) | Independent Non-Executive Director |
|  | **Richard Price** | Non-Executive Director |
|  | **Dominic Slade** | Non-Executive Director |
|  | **Matthew Wyles** | Chief Executive Officer |
|  | **Timothy Blackwell** | Chief Financial Officer |

The Group maintains liability insurance cover for Directors and Officers as permitted by the Companies Act 2006.

## Political and Charitable Donations

The Group made £2k of charitable donations during the year (2021: £nil) and did not make any political donations or incur any political expenditure during the year (2021: £nil).

### Remuneration Matters

The Group adheres to the requirements of the Remuneration Code as defined by the Regulator. The non-executive directors do not receive variable remuneration. Information on the Group's Remuneration Code is set out in the Pillar 3 disclosures and will be published on our website www.htb.co.uk.

### Share capital

Details of share capital as at 31 December are provided in note 37 to the financial statements. The Group did not repurchase any of the issued ordinary shares up to the date of this report.

### Going Concern

The financial statements are prepared on a going concern basis, as the Directors believe that the Group and the Bank have sufficient resources to continue their activities for a period of at least 12 months from the date of approval of the financial statements (the going concern period).

In making this assessment, the Directors have considered the current balance sheet, projections of loan book growth, expected credit losses, profitability, cash flows and capital resources. Under this scenario the Group continues to maintain capital and liquidity at levels significantly above its minimum regulatory requirements throughout the going concern period.

Given the continued economic uncertainties, the Group has undertaken analysis of forecast capital and liquidity levels using the Bank of England Annual Cyclical Scenario 2022. The stress assumes the UK economy enters deep and prolonged recession. The analysis of liquidity under these scenarios also includes short term stresses from our recent ILAAP to assess the impact on the Group's liquidity versus our risk appetite and regulatory requirements. Based on the results of this severe stress scenario analysis, the Directors have concluded that the Group's capital and liquidity forecasts are above its minimum regulatory requirements throughout the going concern period.

Accordingly, the Directors are confident that the Group has adequate resources to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and, therefore, have adopted the going concern basis in preparing the financial statements.

### Reappointment of Auditor

The Auditor, KPMG LLP, have indicated their willingness to continue in office and a resolution seeking to reappoint them will be presented at the AGM.

### Disclosure of Information to Auditor

The Directors who held office at the date of approval of this Directors' report confirm that so far as each of the Directors are aware, there is no relevant audit information of which the Group's auditor is unaware and the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

**Matthew Wyles**

Chief Executive Officer

By order of the Board

27th July 2023

## Statement of Directors' Responsibilities

The directors are responsible for preparing the Strategic Report, the Directors' Report and the Group and parent Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK-adopted International Accounting Standards.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of its profit or loss for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether the financial statements are prepared in accordance with UK-adopted International Accounting Standards;
- assess the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and,
- use the going concern basis of accounting unless they either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Strategic Report and a Directors' Report that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's websites. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## Independent Auditor's Report

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# Independent auditor's report

## to the members of Hampshire Trust Bank plc

### 1. Our opinion is unmodified

We have audited the financial statements of Hampshire Trust Bank plc ("the Company") and its subsidiaries (together "the Group") for the year ended 31 December 2022 which comprise the consolidated and bank statement of comprehensive income, consolidated and bank statement of financial position, consolidated statement of changes in equity, bank statement of changes in equity, consolidated and bank statement of cash flows and the related notes, including the accounting policies in Note 7.

In our opinion:

— the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 December 2022 and of the Group's profit for the year then ended;

— the Group financial statements have been properly prepared in accordance with UK-adopted international accounting standards;

— the parent Company financial statements have been properly prepared in accordance with UK-adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006;

— and the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the shareholders for the year ended 31 December 2006. The period of total uninterrupted engagement is for the 17 financial years ended 31 December 2022.

We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities.

No non-audit services prohibited by that standard were provided.

| Overview | | |
|---|---|---|
| **Materiality:** group financial statements as a whole | £1,730,000<br>4.36% of adjusted group profit before tax | |
| **Key audit matters** | | **vs 2021** |
| **Recurring risks** | Expected credit losses on loans and advances to customers | ◄► |
| | Unobservable inputs into the fair valuation of loans and advances to customers | ◄► |
| | **New**: The impact of IT access controls and change management on the effectiveness of the control environment | ▲ |

## 2. Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters, in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

| | The risk |
|---|---|
| **Expected credit losses on loans and advances to customers**<br><br>(£21.0 million; 2021: £11.2 million)<br><br>*Refer to Note 7.11 (accounting policy) and Note 28 (financial disclosures).* | **Subjective estimate:**<br><br>The measurement of expected credit losses (‘ECL’) involves significant judgements and estimates with a high degree of uncertainty. The risk of material misstatement of ECL is heightened in the current year due to the increased judgement and estimation uncertainty as a result of the ongoing economic uncertainties. The key areas where we have identified greater levels of management judgement and therefore increased levels of audit focus in the estimation of ECL are:<br><br>— **Model estimation**: Inherently judgemental modelling is used to estimate ECL, particularly in determining the probability of default (‘PD’) and loss given default (‘LGD’) in certain portfolios.<br><br>— **Stage allocation criteria:** The criteria selected to identify a significant increase in credit risk (‘SICR’) is a key area of judgement within the Group’s ECL calculation as these criteria determine whether a 12 month or a lifetime provision is recorded.<br><br>— **Post Model Adjustments (‘PMAs’):** Management makes adjustments to the model-driven ECL results to address issues relating to model responsiveness or emerging trends relating to the current economic environment as well as risks not captured by the models. Such adjustments are inherently subjective and significant management judgement is involved in estimating these amounts.<br><br>— **Multiple economic scenarios**: IFRS 9 requires the Group to measure ECL on a forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determine the economic scenarios used and the probability weightings assigned to each economic scenario. In the current year, market reaction towards a high interest rate environment and cost of living pressures heightens the level of subjectivity in this judgement.<br><br>— **Individually assessed stage 3 loans**: Individually assessed stage 3 provisions are inherently judgemental and a highly subjective area that may create the potential for material misstatement of the ECL estimate, with reference to forward looking assumptions (including bespoke recovery assumptions over collateral) applied to cash flow forecasts and the weightings applied to the different scenarios in certain portfolios.<br><br>The effect of these matters is that, as part of our risk assessment, we determined that impairment of loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality and possibly many times that amount.<br><br>**Disclosure quality**<br><br>The disclosures regarding the Group’s application of IFRS 9 are important in explaining the key judgements and material inputs to the IFRS 9 ECL results, as well as the sensitivity of the ECL results to changes in these judgements or management’s assumptions, in light of the estimation uncertainty arising. |

| | Our response |
|---|---|
| **Expected credit losses on loans and advances to customers**<br><br>(£21.0 million; 2021: £11.2 million)<br><br>*Refer to Note 7.11 (accounting policy) and Note 28 (financial disclosures).* | We performed the tests below rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described. Our procedures included:<br><br>— **Our sector experience:** We critically assessed the assumptions inherent in the ECL models against our understanding of the loan portfolios, their recent performance and industry developments. This included benchmarking certain key assumptions against comparable lenders.<br><br>— **Our economic expertise**: Our economists evaluated the appropriateness of the Group's forward economic guidance and the associated probabilities attached to the alternative scenarios against market data, our own independent assumptions and peer experience.<br><br>— **Our credit risk modelling experience**: We utilised our credit risk modelling specialists in evaluating the ECL models. We independently reperformed and inspected the model code for certain components of the ECL model and used our knowledge of the Group and our experience of the industry in which the Group operates to challenge the appropriateness of the qualitative management overlay.<br><br>— **Sensitivity analysis**: We evaluate the sensitivity of changes to judgemental assumptions, to critically assess the impact of alternative assumptions and identify those assumptions most significant to the estimate.<br><br>— **Methodology choice**: We assessed the completeness and effectiveness of the SICR criteria and independently reperformed the application of management's staging criteria for certain portfolios.<br><br>— **Tests of details**: For a sample of loans and advances we conducted credit file reviews to assess the appropriateness of the stage allocation and associated ECL estimate.<br><br>— **Assessing transparency**: We critically assessed the adequacy of the disclosures regarding the degree of estimation uncertainty involved in arriving at the valuation and the accounting judgements made in determining the measurement basis and valuation.<br><br>**Our results**<br><br>— We made judgements in relation to unadjusted audit differences noted in the course of our procedures above. We concluded they did not materially misstate the measurement or disclosures of ECL on the related portfolios.<br><br>— The results of our testing were satisfactory, and we considered the ECL charge, provision recognised and the related disclosures to be acceptable (2021: acceptable). |

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| | The risk | Our response |
|---|---|---|
| **Unobservable inputs into the fair valuation of loans and advances to customers**<br><br>(£4.3 million; 2021: £10.0 million)<br><br>*Refer to Note 7.12 (accounting policy) and Note 27 (financial disclosures).* | **Subjective estimate:**<br><br>The Company holds a portfolio of development finance loans which at origination contained a fee linked to gross development value. In accordance with IFRS 9, these loans are measured at fair value through profit and loss (FVTPL).<br><br>The Company uses a risk adjusted discounted cash flow model (an income based valuation approach) to estimate the fair value of the loans.<br><br>The fair value model uses significant unobservable inputs and as such the loans are classified as level 3 in the fair value hierarchy under IFRS 13.<br><br>A significant audit risk was identified in respect of the unobservable inputs into the valuation. The key unobservable inputs are the timing and amounts of forecast cash flows that are based on estimates of the development completion profile.<br><br>The effect of these matters is that, as part of our risk assessment, we determined that the unobservable inputs into the fair valuation of loans and advances to customers have a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality. The financial statements disclose the sensitivities estimated by the Company (note 27). | We performed the tests below rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described. Our procedures included:<br><br>— **Methodology choice**: We challenged management on the appropriateness of the methodology used to value the loans, notably the suitability of the model and the discounting rate methodology.<br><br>— **Independent repricing**: We engaged KPMG specialists to independently rebuild the model and test the observable inputs.<br><br>— **Historical forecast accuracy:** We assessed the accuracy of historical cash flow forecasts, and challenged instances of divergence between actual cash flows and those forecasted.<br><br>— **Challenge of key assumptions**: We challenged management on key assumptions around forecast future cash flows and whether they are appropriate.<br><br>— **Assessing transparency**: We critically assessed the adequacy of the disclosures regarding the degree of estimation uncertainty involved in arriving at the valuation and the accounting judgements made in determining the measurement basis and valuation.<br><br>**Our results**<br><br>— We performed an assessment of whether an over/understatement of the estimate of fair value identified through these procedures was material.<br><br>— We found the resulting estimate of the unobservable inputs into the fair value of loans and advances to customers and the associated disclosures made to be acceptable (2021: acceptable). |
| **The impact of IT access controls and change management on the effectiveness of the control environment** | **Data capture:**<br><br>As with many banking groups, the Group makes extensive use of IT for the processing and recording of transactions. In our testing of the general IT controls, we identified deficiencies in certain areas of user access and change management for certain systems.<br><br>We consider IT user access and change management controls to be critical in ensuring that only approved changes to applications and underlying data are authorised and made appropriately. Moreover, appropriate access controls contribute to mitigating the risk of potential fraud or error as a result of changes to applications and data.<br><br>As a result of the above deficiencies, we regard this area as a key audit matter owing to the additional work necessary to address the incremental audit risk.<br><br>In line with many UK banks, the Group already has a program of work underway to improve its IT infrastructure. These plans now include firm commitments to remediate the aforementioned user access controls and change management deficiencies in the course of 2023. | Our procedures included:<br><br>• **Control operation:** With the assistance of our IT specialists, we evaluated the design and operating effectiveness of the controls over the continued integrity of the IT systems that are relevant to financial reporting including general IT controls over user access (including controls over privileged access) and change management (including program development and change).<br><br>• **Extended scope:** We performed additional tests of detail as a result of the general IT control deficiencies. This work included manually re-performing certain system generated reconciliations, additional testing of system records to underlying source documentation, increased sample sizes, and manually comparing certain system generated reports to confirm correct data transfer.<br><br>**Our results**<br><br>• Our testing identified weaknesses in the design and operation of user access and change management controls. As a result we expanded the extent of our detailed testing, as set out above, over and above that originally planned. |

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### 3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at £1,730,000, determined with reference to a benchmark of Group profit before tax normalised to exclude the gain on bargain purchase of £48,708,000, of which it represents 4.36%. We adjusted for this item because it does not represent the normal, continuing operations of the Group.

Materiality for the parent Company financial statements as a whole was set at £1,550,000 (2021: £1,050,000), which is the component materiality for the parent company determined by the group audit engagement team. This is lower than the materiality we would otherwise have determined with reference to a benchmark of Company profit before tax normalised to exclude dividends of £20,000,000 (2021: £nil), of which it represents 3.48% (2021: 3.84%). We would have adjusted for this item because it does not represent the normal, continuing operations of the Company.

In line with our audit methodology, our procedures on individual account balances and disclosures were performed to a lower threshold, performance materiality, so as to reduce to an acceptable level the risk that individually immaterial misstatements in individual account balances add up to a material amount across the financial statements as a whole.

Performance materiality was set at 75% (2021: 75%) of materiality for the financial statements as a whole, which equates to £1,290,000 for the Group and £1,160,000 (2021: £785,000) for the parent Company. We applied this percentage in our determination of performance materiality because we did not identify any factors indicating an elevated level of risk.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £86,500 (2021: £52,500), in addition to other identified misstatements that warranted reporting on qualitative grounds.

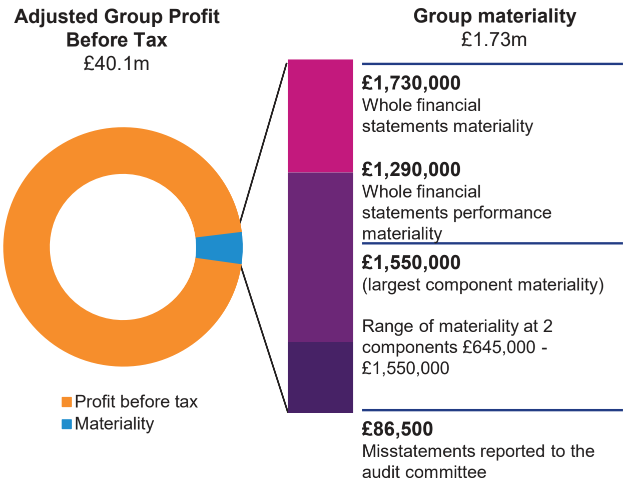
Of the Group's 7 reporting components, we subjected 2 to full scope audits for group purposes.

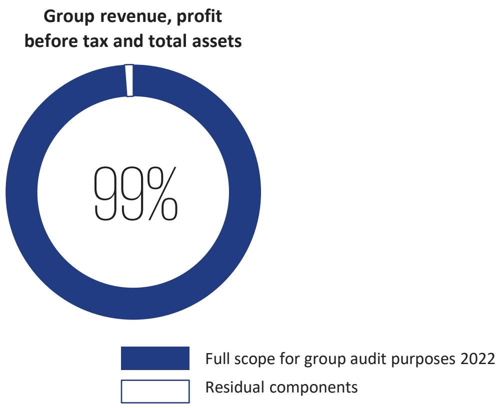
The components within the scope of our work accounted for the percentages illustrated opposite.

The remaining 1% of total Group revenue, profit before tax and total assets is represented by 5 of the remaining reporting components, none of which individually represented more than 1% of total Group revenue, profit before tax or total assets. For these components, we performed analysis at an aggregated group level to re-examine our assessment that there were no significant risks of material misstatement within these.

Our audit of the Group, and 2 of the 7 components, was undertaken to the materiality and performance materiality levels specified above and was performed by a single audit team.

We were able to rely upon the Group's internal control over financial reporting in some areas of our audit, where our controls testing supported this approach, which enabled us to reduce the scope of our substantive audit work; in the other areas the scope of the audit work performed was fully substantive.

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## 4. Going concern

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Group or the Company or to cease its operations, and as they have concluded that the Group's and the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We used our knowledge of the Group, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Group's and the Company's financial resources or ability to continue operations over the going concern period. The risk that we considered most likely to adversely affect the Group's and Company's available financial resources over this period was an increase in the levels of expected credit losses due to estimation uncertainty, which could lead to insufficient capital resources to meet minimum regulatory capital requirements over the course of the next 12 months.

We considered whether these risks could plausibly affect the liquidity in the going concern period by comparing severe, but plausible downside scenarios that could arise from these risks individually and collectively against the level of available financial resources indicated by the Group's financial forecasts.

Our procedures also included:

— Inspecting the Group's forecasting and liquidity plans to identify the key assumptions within these, and challenging the reasonableness of the assumptions and stresses applied, and comparing the accuracy of management prior projections versus actuals;

— Considering sensitivities over the level of available capital and liquidity indicated by the Group's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively; and

— Assessing the completeness of the going concern disclosure.

Our conclusions based on this work:

— we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate;

— we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Group's or the Company's ability to continue as a going concern for the going concern period; and

— we found the going concern disclosure in note 2 to be acceptable.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the above conclusions are not a guarantee that the Group or the Company will continue in operation.

## 5. Fraud and breaches of laws and regulations – ability to detect

*Identifying and responding to risks of material misstatement due to fraud*

To identify risks of material misstatement due to fraud ("fraud risks") we assessed events or conditions that could indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud. Our risk assessment procedures included:

— Enquiring of Directors as to the Group's high-level policies and procedures to prevent and detect fraud, as well as whether they have knowledge of any actual, suspected or alleged fraud;

— Review of the Group's internal audit reports, and Board Minutes of the Group; and

— Using analytical procedures to identify any unusual or unexpected relationships.

We communicated identified fraud risks throughout the audit team and remained alert to any indications of fraud throughout the audit.

As required by auditing standards, and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, in particular the risk that management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements.

On this audit we do not believe there is a fraud risk related to revenue recognition due to the non-judgemental nature of the majority of the company's revenue streams, the limited estimation uncertainty in EIR recognition and the lack of opportunity to manipulate revenue.

We also identified fraud risks relating to ECL provisioning and unobservable inputs into the valuation of level 3 loans and advances.

We performed procedures including:

— Identifying journal entries to test based on high risk criteria including manual journal entries posted to seldom-used accounts or by individuals who typically do not make journal entries and journals containing specific key words, and comparing the identified entries to supporting documentation;

— Evaluating the design and implementation and operating effectiveness of relevant internal controls;

— Assessing significant accounting estimates for bias; and

— Substantive procedures to address the fraud risk.

*Identifying and responding to risks of material misstatement due to non-compliance with laws and regulations*

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience through discussion with the Directors and other management (as required by auditing standards), and from inspection of the Group's regulatory and legal correspondence and discussed with the Directors and other management the policies and procedures regarding compliance with laws and regulations.

*Auditor's responsibilities*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

## 9. The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

R Rawstron

**Richard Rawstron (Senior Statutory Auditor)**
**for and on behalf of KPMG LLP, Statutory Auditor**
*Chartered Accountants*
15 Canada Square
London
E14 5GL
28 July 2023

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# 4 Financial Statements

## Consolidated and Bank Statement of Comprehensive Income

| | Note | Group 2022 £000 | Group 2021 £000 | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|---|---|---|
| Interest and similar income | | | | | |
| Interest income calculated using "EIR" method | 8 | 150,137 | 86,057 | 130,744 | 86,057 |
| Other interest income | 8 | 1,095 | 2,451 | 1,095 | 2,451 |
| **Total interest and similar income** | | **151,232** | **88,508** | **131,839** | **88,508** |
| Interest expense and similar charges | 8 | (39,934) | (19,351) | (33,255) | (19,351) |
| **Net Interest Income** | | **111,298** | **69,157** | **98,584** | **69,157** |
| Operating lease income | 9 | 1,646 | - | - | - |
| Fees and commissions income | 9 | 3,105 | 1,533 | 2,078 | 1,533 |
| Fees and commissions payable | 9 | (1,690) | (805) | (1,637) | (805) |
| Net gain/(loss) on loans and other financial assets at fair value through profit or loss | 10 | 3,276 | 3,175 | 3,276 | 3,175 |
| Other Income | 11 | (2) | 9 | 6,512 | 9 |
| **Operating Income** | | **117,633** | **73,069** | **108,813** | **73,069** |
| Administrative expenses | 12 | (69,881) | (46,313) | (56,984) | (46,313) |
| Impairment gains/(losses) on Loans and Advances to customers | 28 | (8,101) | 590 | (7,308) | 590 |
| Gain on bargain purchase | 40 | 48,708 | - | - | - |
| **Profit before tax and dividends** | | **88,359** | **27,346** | **44,521** | **27,346** |
| Interim Dividend received | 16 | - | - | 20,000 | - |
| **Profit before tax** | | **88,359** | **27,346** | **64,521** | **27,346** |
| Tax expense | 17 | (10,274) | (6,784) | (10,488) | (6,784) |
| **Profit after tax for the year** | | **78,085** | **20,562** | **54,033** | **20,562** |
| **Other Comprehensive Income** | | | | | |
| **Items that are or may be reclassified subsequently to Profit and loss:** | | | | | |
| Cash flow hedges – effective portion of changes in fair value | 21 | 125 | - | 125 | |
| Cash-flow hedges – recycled to profit or loss | 21 | 4 | - | 4 | - |
| **Total Comprehensive Income for the year after tax** | | **78,214** | **20,562** | **54,162** | **20,562** |

The notes on pages 69 to 145 are an integral part of these financial statements.

## Consolidated and Bank Statement of Financial Position

| | Note | Group 2022 £000 | Group 2021 £000 | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Loans and Advances to Banks | 19 | 462,609 | 242,323 | 458,974 | 242,323 |
| Loans and Advances to Customers - FVTPL | 22 | 4,294 | 10,025 | 4,294 | 10,025 |
| Loans and Advances to Customers – at amortised cost | 23 | 2,650,063 | 1,704,683 | 2,243,123 | 1,704,683 |
| Investment Securities | 24 | 262,375 | 196,712 | 217,722 | 196,712 |
| Derivative Assets held for Risk Management | 20 | 113,319 | 19,458 | 113,319 | 19,458 |
| Investment in Subsidiaries | 40 | - | - | 49,422 | - |
| Property, Plant and Equipment | 30 | 4,079 | 1,471 | 1,443 | 1,471 |
| Right-of-Use Assets | 31 | 762 | 1,608 | 685 | 1,608 |
| Intangible Assets | 32 | 11,929 | 7,606 | 9,464 | 7,606 |
| Other Assets | 33 | 27,012 | 4,720 | 99,498 | 4,720 |
| Deferred tax asset | 18 | 9,390 | 1,925 | 2,538 | 1,925 |
| **Total Assets** | | **3,545,832** | **2,190,531** | **3,200,482** | **2,190,531** |
| **Liabilities** | | | | | |
| Derivative Liabilities held for Risk Management | 20 | 19,136 | 4,413 | 19,136 | 4,413 |
| Customer Deposits | 26 | 2,673,491 | 1,633,046 | 2,420,694 | 1,633,046 |
| Finance Lease Liability | 31 | 923 | 1,895 | 647 | 1,895 |
| Other Liabilities | 34 | 145,981 | 37,139 | 175,805 | 37,139 |
| Central Bank Facilities | 25 | 393,049 | 295,000 | 295,000 | 295,000 |
| Subordinated Liabilities | 35 | 30,336 | 30,202 | 30,336 | 30,202 |
| **Total Liabilities** | | **3,262,916** | **2,001,695** | **2,941,618** | **2,001,695** |
| **Equity** | | | | | |
| Share Capital | 37 | 139,828 | 139,828 | 139,828 | 139,828 |
| Share Premium | | 196 | 196 | 196 | 196 |
| Cash flow hedge reserve | 37 | 129 | - | 129 | - |
| Retained Earnings | | 125,733 | 48,812 | 101,681 | 48,812 |
| **Total equity, excluding non-controlling interest** | | **265,886** | **188,836** | **241,834** | **188,836** |
| Other Equity Instruments attributable to non-controlling interests | 37 | 17,030 | - | 17,030 | - |
| **Total Equity** | | **282,916** | **188,836** | **258,864** | **188,836** |
| **Total Equity and Liabilities** | | **3,545,832** | **2,190,531** | **3,200,482** | **2,190,531** |

The notes on pages 69 to 147 are an integral part of these financial statements.

These financial statements were approved by the Board of Directors and signed on its behalf on 27 July 2023.

**Matthew Wyles**

Director
Company Number: 1311315

**Timothy Blackwell**

Director

## Consolidated Statement of Changes in Equity

For the year ended 31 December 2022

| | Share Capital £000 | Share Premium £000 | Cashflow Hedge Reserves £000 | Retained Earnings £000 | Attributable to Ordinary Shareholders £000 | Other equity reserves £000 | Total Equity £000 |
|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2022** | **139,828** | **196** | **-** | **48,812** | **188,836** | **-** | **188,836** |
| Comprehensive Income for the year | | | | | | | |
| Profit for the year | - | - | - | 78,085 | 78,085 | - | 78,085 |
| Cash flow hedges – effective portion of changes in fair value | - | - | 125 | - | 125 | - | 125 |
| Cash-flow hedges – recycled to profit or loss | - | - | 4 | - | 4 | - | 4 |
| **Total Comprehensive Income for the year** | **-** | **-** | **129** | **78,085** | **78,214** | **-** | **78,214** |
| Equity settled share-based payment | - | - | - | 240 | 240 | - | 240 |
| Issue of other equity instruments | - | - | - | - | - | 17,030 | 17,030 |
| Coupon paid on other equity instruments | - | - | - | (1,404) | (1,404) | - | (1,404) |
| **Balance at 31 December 2022** | **139,828** | **196** | **129** | **125,733** | **265,886** | **17,030** | **282,916** |

The notes on pages 69 to 145 are an integral part of these financial statements.

# Consolidated Statement of Changes in Equity

For the year ended 31 December 2021

| | Share Capital £000 | Share Premium £000 | Retained Earnings £000 | Total Equity £000 |
|---|---|---|---|---|
| **Balance at 1 January 2021** | **126,288** | **196** | **27,574** | **154,058** |
| **Comprehensive Income for the year** | | | | |
| Profit for the year | - | - | 20,562 | 20,562 |
| **Total Comprehensive Income for the year** | **-** | **-** | **20,562** | **20,562** |
| Equity settled share-based payment | - | - | 676 | 676 |
| Issue of share capital | 13,540 | - | - | 13,540 |
| **Balance at 31 December 2021** | **139,828** | **196** | **48,812** | **188,836** |

The notes on pages 69 to 145 are an integral part of these financial statements.

## Bank Statement of Changes in Equity

For the year ended 31 December 2022

| | Share Capital £000 | Share Premium £000 | Cashflow Hedge Reserves £000 | Retained Earnings £000 | Attributable to Ordinary Shareholders £000 | Other equity reserves £000 | Total Equity £000 |
|---|---|---|---|---|---|---|---|
| **Balance at 1 January 2022** | **139,828** | **196** | | **48,812** | **188,836** | **-** | **188,836** |
| Comprehensive Income for the year | | | | | | | |
| Profit for the year | - | - | - | 54,033 | **54,033** | - | 54,033 |
| Cash flow hedges – effective portion of changes in fair value | - | - | 125 | - | **125** | - | 125 |
| Cash-flow hedges – recycled to profit or loss | - | - | 4 | - | **4** | - | 4 |
| **Total Comprehensive Income for the year** | **-** | **-** | **129** | **54,033** | **54,162** | **-** | **54,162** |
| Equity settled share-based payment | - | - | - | 240 | **240** | - | 240 |
| Issue of other equity instruments | - | - | - | - | **-** | 17,030 | 17,030 |
| Coupon paid on other equity instruments | - | - | - | (1,404) | **(1,404)** | - | (1,404) |
| **Balance at 31 December 2022** | **139,828** | **196** | **129** | **101,681** | **241,834** | **17,030** | **258,864** |

The notes on pages 69 to 145 are an integral part of these financial statements.

## Bank Statement of Changes in Equity

For the year ended 31 December 2021

| | Share Capital £000 | Share Premium £000 | Retained Earnings £000 | Total Equity £000 |
|---|---|---|---|---|
| **Balance at 1 January 2021** | **126,288** | **196** | **27,574** | **154,058** |
| Comprehensive Income for the year | | | | |
| Profit for the year | – | – | 20,562 | **20,562** |
| **Total Comprehensive Income for the year** | **–** | **–** | **20,562** | **20,562** |
| Equity settled share-based payment | – | – | 676 | **676** |
| Issue of share capital | 13,540 | – | – | **13,540** |
| **Balance at 31 December 2021** | **139,828** | **196** | **48,812** | **188,836** |

The notes on pages 69 to 145 are an integral part of these financial statements.

## Consolidated and Bank Statement of Cash flows

| | Group 2022 £000 | Group 2021 £000 | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|---|---|
| **Cashflows from operating activities** | | | | |
| Profit before tax for the year | 88,359 | 27,346 | 64,521 | 27,346 |
| *Adjustments for:* | | | | |
| Depreciation and amortisation | 7,314 | 3,936 | 4,411 | 3,936 |
| Foreign Exchange Gains/(Losses) | (2) | 9 | (2) | 9 |
| Increase in impairment of Loans and Advances | 16,677 | 6,362 | 11,995 | 6,362 |
| Increase/(Decrease) in provisions | (4,789) | (4,206) | 3,215 | (4,206) |
| Equity-settled share based payment transactions | 240 | 676 | 240 | 676 |
| Bond premium/discount amortisation | (335) | 1,275 | (335) | 1,275 |
| (Increase)/Decrease in Fair Value of Derivative Assets | (76,695) | (28,408) | (76,695) | (28,408) |
| (Increase)/Decrease in Fair Value of loans and advances designated as hedged items | 73,530 | 25,595 | 73,530 | 25,595 |
| (Increase)/Decrease in Fair Value of Loans and Advances held at FVTPL | (6,981) | (749) | (6,981) | (749) |
| Repayment of the interest accrued on finance lease liabilities | 87 | (129) | 70 | (129) |
| Dividend received | - | - | (20,000) | - |
| Gain on bargain purchase | (48,708) | - | - | - |
| Other acquisition costs recognised through equity | (146) | - | (392) | - |
| Corporation Tax paid | (14,257) | (3,709) | (14,257) | (3,709) |
| **Changes in:** | | | | |
| (Increase) in Loans and Advances to Customers | (542,245) | (419,379) | (625,569) | (419,379) |
| (Increase)/Decrease in Other Assets | (18,708) | (508) | (94,775) | (508) |
| Increase in Central Bank Facilities | 1,281 | 115,000 | - | 115,000 |
| Decrease/(Increase) in collateral held with banks | 73,421 | 27,594 | 73,421 | 27,594 |
| Increase in Customer Deposits | 648,829 | 512,682 | 798,748 | 512,682 |
| Increase/(Decrease) in Subordinated and Other Liabilities | 30,863 | 3,637 | 68,205 | 3,637 |
| **Net cash flow from operating activities** | **227,735** | **267,024** | **259,350** | **267,024** |

# Consolidated and Bank Statement of Cash flows (continued)

| | Group 2022 £000 | Group 2021 £000 | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|---|---|
| **Cash flows from Investing Activities** | | | | |
| Acquisition of subsidiary, net of cash acquired | 33,482 | - | (32,000) | - |
| Dividend received from subsidiary undertakings | - | - | 20,000 | - |
| Purchase of Property, Plant and Equipment | (1,356) | (231) | (543) | (231) |
| Purchase of Intangible Assets | (4,838) | (3,355) | (4,777) | (3,355) |
| Purchase of Investment Securities | (434,322) | (178,144) | (424,657) | (178,144) |
| Disposal of Property, Plant and Equipment | 433 | - | - | - |
| Settlement of Investment Securities | 402,000 | - | 402,000 | - |
| **Net cash flow from Investing Activities** | **(4,601)** | **(181,730)** | **(39,977)** | **(181,730)** |
| **Cash flows from Financing Activities** | | | | |
| Repayments of the principal portion of finance lease liabilities | (1,444) | (1,183) | (1,318) | (1,183) |
| Proceeds from the issue of share capital | - | 13,540 | - | 13,540 |
| Coupon paid to other equity instrument holders | (1,404) | - | (1,404) | - |
| **Net increase/(decrease) in Cash and Cash Equivalents** | **220,286** | **97,651** | **216,651** | **97,651** |
| Cash and cash equivalents at 1 January | 242,323 | 144,672 | 242,323 | 144,672 |
| **Cash and Cash Equivalents at 31 December** | **462,609** | **242,323** | **458,974** | **242,323** |
| Loans and advances to Banks[1] | 462,609 | 242,323 | 458,974 | 242,323 |
| **Cash and Cash Equivalents at 31 December** | **462,609** | **242,323** | **458,974** | **242,323** |

The notes on pages 69 to 145 are an integral part of these financial statements.

1 Loans and Advances to Banks for both the Group and the Bank includes restricted balance held in the Bank of England in the form of cash ratio deposits of £3.6m (2021: £1.1m)

# Notes to the financial statements

This section describes the Group's significant policies and critical accounting estimates that relate to the financial statements and notes. If an accounting policy or a critical accounting estimate relates to a particular note, the accounting policy and/or critical accounting estimate is contained within the relevant note.

## 1. Reporting entity

Hampshire Trust Bank PLC (the 'Bank') is domiciled in the United Kingdom, a company limited by shares. The Consolidated Financial Statements of the Group as at and for the year ended 31 December 2022 comprise the Bank and its subsidiaries (together referred to as the "Group") as listed in note 39.

## 2. Basis of Preparation

The Group's financial statements have been prepared in accordance with UK adopted International Accounting Standards.

These financial statements are presented in Pounds Sterling (GBP), which is the Group's functional currency. All amounts have been rounded to the nearest thousand except when otherwise stated.

The Group primary financial statements have been presented in a manner to show the comparatives between the Group results in 2022 against 2021, and the Bank results in 2022 against 2021. Given that the Group results for 2021 are the same as the Bank results in 2021 (during 2021 the Group only consisted of HTB), and in order to aid user readability, the notes to the financial statements will be presented as single columns stating "Group and Bank 2021". Note 40 has further information on the structure of the group and the acquisition of WBL during 2022.

### Going concern

The financial statements are prepared on a going concern basis, as the Directors believe that the Group has sufficient resources to continue their activities for a period of at least 12 months from the date of approval of the financial statements (the going concern period).

For the year ended 31 December 2022, the Group recognised a net profit of £78.1m. The Group's total assets as at 31 December 2022 were £3,546m. The Group has £725m of resources comprising cash and cash equivalents, and other highly liquid assets as at 31 December 2022.

In making their assessment, the Directors have considered the current position, as detailed above, together with projections of loan book growth, expected credit losses, profitability, cash flows and capital resources. Under this scenario the Group continues to maintain capital and liquidity at levels significantly above its minimum regulatory requirements throughout the going concern period.

Given the continued economic uncertainties, the Group has undertaken analysis of forecast capital and liquidity levels using the Bank of England Annual Cyclical Scenario 2022. The stress assumes the UK economy enters deep and prolonged recession. The analysis of liquidity under these scenarios also includes short term stresses from our recent ILAAP to assess the impact on the Group's liquidity versus our risk appetite and regulatory requirements. Based on the results of this severe stress scenario analysis, the Directors have concluded that the Group's capital and liquidity forecasts are above its minimum regulatory requirements throughout the going concern period.

Accordingly, the Directors are confident that the Group has adequate resources to continue to meet its liabilities as they fall due for at least 12 months from the date of approval of the financial statements and, therefore, have adopted the going concern basis in preparing the financial statements.

## 3. Basis of consolidation

### 3.1. Subsidiaries

Subsidiaries are entities controlled by the Group. Control is achieved where the Group is exposed to, or has rights to, variable returns from its involvement with the subsidiary and has the ability to affect those returns through its power over the subsidiary. The financial statements of the subsidiaries are included in the consolidated financial statements from the date on which control commences until the date when control ceases. All intra-group transactions, balances, income and expenses are eliminated in preparing the consolidated financial statements.

### 3.2. Business combinations

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group.

The Group recognises identifiable assets and liabilities at their acquisition date fair values. Fair values are determined from the estimated future cash flows generated by the assets. The cost of an acquisition is measured as the aggregate of the consideration transferred at acquisition date fair value and the amount of any non-controlling interests in the acquiree. When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition.

The consideration transferred in the acquisition is measured at fair value. Any gain on bargain purchase is recognised in profit or loss immediately at the date of acquisition.

Any contingent or deferred consideration payable is measured at fair value at the acquisition date. If the contingent or deferred consideration is classified as equity, then it is not re-measured and settlement is accounted for within equity. Otherwise, subsequent changes in fair value of the contingent or deferred consideration are recognised in profit or loss.

A Joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement, rather than rights to its assets and obligations for its liabilities. Interest in joint ventures are account for using the equity method. They are initially recognised at cost which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and OCI of equity-accounted investees, until the date of which significant influence or joint control ceases.

## 4. Changes in significant accounting policies

The Group considered the following standards and amendments to standards from 1 January 2022:

- Onerous contracts – cost of fulfilling a contract – Amendments to IAS 37
- Property, Plant and Equipment – Proceeds before intended use – Amendments to IAS 16

The effect of these amendments has been deemed as immaterial to the Group's financial statements.

## 5. Use of judgments and estimates

In preparing these financial statements, management has made judgements, estimates and assumptions that affect the application of the Group's accounting policies and the reported amounts of assets, liabilities, income and expenses.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognised prospectively. The significant estimates and judgements made by management in applying accounting policies and the key sources of estimation uncertainty in these financial statements, which together are deemed critical to the results and financial position, are presented within the notes to the accounts as shown below:

**A. Judgements**

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in the financial statements are included in the following notes:

- **Note 7.9:** classification of financial assets: assessment of the business model within which the assets are held and assessment of whether the contractual terms of the financial asset are SPPI on the principal amount outstanding.
- **Note 7.11:** establishing the criteria for determining whether credit risk on the financial asset has increased significantly since initial recognition, determining the methodology for incorporating forward-looking information into the measurement of ECL and selection and approval of models used to measure ECL.

**B. Assumptions and estimation uncertainties**

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment in the year ended 31 December 2022 are included in the following notes:

- **Note 7.11:** allowance for credit impairment losses on financial assets at amortised cost: determination of inputs into the ECL measurement model, including key assumptions used in estimating recoverable cash flows and incorporation of forward-looking information.
- **Note 7.12:** measurement of the fair value of financial instruments with significant unobservable inputs.

## 6. Future accounting developments

IFRS 17 – Insurance Contracts is effective for accounting periods beginning on or after 1 January 2023. The IASB has also issued minor amendments to IFRSs effective from 1 January 2023. The Group is currently assessing the impacts of these however they are not expected to have a material impact on the Group.

## 7. Significant accounting policies

### 7.1. Interest income and expense on instruments measured at amortised cost

Interest income and expense are recognised in the Statement of Comprehensive Income for all instruments measured at amortised cost using the effective interest rate ("EIR") basis.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or financial liability and of allocating the interest income or interest expense over the relevant period. The EIR is the rate that exactly discounts estimated future cash flows through the expected lives of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group takes into account all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Interest on impaired financial assets is recognised at the same EIR as applied at the initial recognition of the financial asset but applied to the book value of the financial asset net of any impairment allowance.

In determining the expected life of loans and receivables assets, the Group uses judgement on the likely redemption profiles. The Group also forecasts and estimates the likely level of early repayment charges. At regular intervals throughout the year, the expected lives of loans and receivables assets are reassessed for reasonableness. Any variation in the expected life of these assets will change the carrying value in the statement of financial position and the timing of the recognition of interest income.

Interest income and expenses presented include:

- Interest on financial assets and financial liabilities measured at amortised cost calculated on EIR basis.
- Interest on financial assets and financial liabilities measured at Fair value through profit and loss ('FVTPL')
- Interest expense on lease liabilities.
- Interest income from Finance Leases and Hire Purchase is recognised over the period of the agreement to give a constant rate of return.

### 7.2. Fee and commission income

Fees and commissions which are not considered integral to the effective interest rate are generally recognised when the service has been provided and the Group has satisfied its performance obligations per IFRS 15 and collection is considered probable.

These fees from contracts with customers is measured based on the consideration specified in a contract with a customer. The Group recognises revenue when it transfers control over a service to a customer.

Fees and commission income include customer service fees, wholesale facility fees, placement fees, which are recognised as the related services are performed (at a point in time or over time).

Fees and commission income include non-refundable commitment fees charged in advance for Development Finance loans held at FVTPL these are accounted for under IFRS 9 and are recognised in full on receipt of the fee.

Fees and commission expense include transaction and service fees, which are expensed as the services are received. None of the fees and commission charged arose from variable consideration and fees charged are generally not refundable unless under exceptional circumstances.

### 7.3. Net income from other financial instruments at FVTPL

#### *7.3.1. Development Finance ("DF") loans*

- Certain DF loans are measured at FVTPL because the contractual cash flows are not SPPI.
- Income from those DF loans will be shown within this line and excludes the interest income on such loans. The related interest income is presented as part of other interest income. Interest income is the contractual interest charged on the loan when held at amortised cost.

#### *7.3.2. Derivatives*

Net income from derivatives relates to non-trading derivatives held for risk management purposes that do not form part of a qualifying hedging arrangement:

- The fair value movement on derivatives held for economic hedging where hedge accounting is not applied are presented in 'Net income from other financial instruments at FVTPL. However, for designated and effective fair value hedge accounting relationships the gains and losses on the hedging instrument are presented in the same line in the profit and loss as the hedged item.

### 7.4. Employee benefits

The Group applies IAS 19 Employee benefits in its accounting for components of staff costs.

#### *7.4.1. Short-term employee benefits*

Short-term employee benefits are expensed as the related service is provided. A liability is recognised for the amount expected to be paid if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

#### 7.4.2. Defined contribution plans

Obligations for contributions to defined contribution plans are expensed as the related service is provided and recognised as pension costs in the income statement.

#### 7.4.3. Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits is the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value. Remeasurements are recognised in profit or loss in the period in which they arise.

### 7.5. Share based payments

Employees may be entitled to receive remuneration in the form of shares to reward strong long-term business performance and to incentivise growth for the future. These share-based payment transactions are accounted for as equity settled share-based payments in accordance with IFRS 2. This equity is in the 'B' Ordinary Shares of the Group's parent company, Hoggant Ltd.

The grant date fair value of a share-based payment transaction is recognised as an employee expense, with a corresponding increase in equity over the vesting period of the awards.

The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market performance conditions are expected to be met, such that the amount ultimately recognised is based on the number of awards that meet the related service and non-market performance conditions at the vesting date.

The amount recognised as an expense in the Income Statement is based on amortising the grant date fair value at a constant rate to the vesting date.

#### 7.5.1. Scheme Details

The Incentive Share scheme, comprising 'B' Ordinary shares issued by Hoggant Ltd (HTB's parent company), was introduced for directors and senior employees of the Group on 21 May 2014. All shares were issued at a price of £0.01p per share. Holders are entitled to receive a return on the shares acquired in the event of a prescribed exit event.

The Incentive Share scheme is governed by Hoggant's Articles of Association and is deemed by Management to be an equity settled scheme and has been accounted for as such in the financial statements of the Bank and the Group.

The Group's long-term incentive share scheme is subject to two conditions. A service and a non-market performance condition. Employees must remain in service until the exit event happens (exit being the non-market performance condition). Therefore, there is a variable vesting period. The exit condition influences the length of the estimated vesting period.

The fair values of the shares at the date of grant were valued using the Black-Scholes valuation model. The significant inputs into this model were expected term, risk free interest rate, expected dividend yield, equity value at grant date and volatility. Management has estimated the vesting period over which these shares will vest. The assumptions used are as follows:

| | 2022 | 2021 | 2020 |
|---|---|---|---|
| Expected volatility | 28.9% to 30.6% | 28.9% to 30.6% | 26.7% to 30.2% |
| Risk free rate | -0.1% to 3.5% | -0.1% to 1.3% | -0.1% to 1.3% |
| Dividend yield | 0.0% | 0.0% | 0.0% |
| Expected life | 2 years | 3 years | 4 years |

Although the Black-Scholes equation assumes predictable constant volatility, this is not observed in real markets. In order to estimate the annualised volatility we have assessed the past standard deviation of the stock price of comparable quoted banks over a period commensurate with the expected term.

## 7.6. Leases

### *7.6.1. As a lessee*

The Group recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to office premises.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate.

The incremental borrowing rate is determined by analysing borrowings from/to external sources adjusted to reflect the terms of the lease and the type of asset leased.

The Group has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases, including leases of IT equipment. The Group recognises the lease payments with these leases as an expense on a straight-line basis over the lease term. For property leases, the Group has elected to separate the non-lease and lease component.

### *7.6.2. As a lessor*

At lease inception, the lessor determines whether the lease is a finance lease or an operating lease.

To classify each lease, the Group makes an overall assessment of whether the lease transfers substantially all the risks and rewards incidental to ownership of the underlying asset. If this is the case, then the lease is a finance lease. If not, then it is an operating lease. As part of this assessment, the Group considers certain indicators such as whether the lease is for the major part of the economic life of the asset.

Assets leased to customers are finance leases per IFRS 16. When assets are leased to customers under finance leases, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised within interest income.

The Group applies the derecognition and impairment requirements in IFRS 9 to the net investment in the lease.

The Group has made a judgement on extending the lease term of the Leeds office to 2023 and the landlord exercised a break clause terminating the lease of the Group's London office in 2023. This will be reassessed at each reporting period.

The discount rate used in the calculation of lease liability, is an estimation. For the property leases, the rate implicit in the Group's property leases cannot be determined and it is unclear what a market rate for a secured loan provided to a Bank would be. In practice, banks do not enter into mortgage contracts with other lenders, particularly ones with such short terms, therefore, a rate of 5.0% would be an equivalent market rate to borrow a similar amount, on a secured basis, over a similar term, given the Group's current credit standing.

The Group uses two data centre providers where the Group has the right to direct the use of the asset and obtain all economic benefits relating to the asset i.e. access to physical cabinets and therefore within the scope of IFRS 16. Due to the nature of the rolling contracts, we have taken the exemption of short-term leases on those agreements.

### 7.7. Dividend Income

Dividend income is recognised when the right to receive income is established. Dividends are presented based on the underlying classification of the equity instruments.

### 7.8. Income tax

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided in full using the liability method on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### 7.9. Financial assets & liabilities

Loans and advances include:

- Loans and advances measured at amortised cost – they are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.
- Loans and advances mandatorily measured at FVTPL or designated as at FVTPL – these are measured at fair value with changes recognised immediately in profit or loss.
- Lease receivables.

Investment Securities include:

- Covered bonds measured at amortised cost. These are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective interest method.

#### *7.9.1. Classification*

A financial asset is measured at amortised cost if both the following conditions are met, and it has not been designated at FVTPL:

- The asset is held within a business model where the objective is to hold the asset to collect its contractual cash flows.
- The contractual terms of the financial asset give rise to cash flows on specified dates that represent payments of solely principal and interest (“SPPI”) on the outstanding principal amount.

A debt instrument would be measured at Fair value through other comprehensive income ('FVOCI') only if both below conditions are met and it has not been designated as FVTPL:

- The asset is held within a business model where the objective is achieved by both collecting its contractual cash flows and selling the financial asset.
- The contractual terms of the financial asset give rise to cash flows on specified dates that represent payments of solely principal and interest on the outstanding principal amount.

All other financial assets are classified as measured at FVTPL.

#### *7.9.2. Business model assessment*

The Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed, and information is provided to management. The information considered includes:

- The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile or realising cash flows through the sale of the assets.
- How the performance of the portfolio is evaluated and reported to the Group's management.
- The risks that affect the performance of the business model (and the financial assets held within that business model) and its strategy for how those risks are managed.

The Group's current business model for all financial assets is to hold to collect contractual cash flows.

#### *7.9.3. Significant judgement: Assessment of whether contractual cash flows are SPPI*

For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset on initial recognition. 'Interest' is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin.

In assessing whether the contractual cash flows are SPPI, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- Contingent events that would change the amount and timing of cash flows.
- Leverage features.
- Prepayment and extension terms.
- Terms that limit the Group's claim to cash flows from specified assets (e.g. non-recourse loans).
- Features that modify consideration of the time value of money (e.g. periodical reset of interest rates).

The Group holds a portfolio of Development Finance loans which have contingent exit fees. As these fees are contingent on the value of the finished development, the Group deems these loans to fall outside of SPPI and has mandatorily reclassified these assets at FVTPL.

#### *7.9.4. De-recognition*

The Group derecognises a financial asset when the contractual right to the cash flows from the financial asset expires or it transfers the right to receive contractual cash flows in a transaction in which substantially all the risks and rewards of the financial asset are transferred.

On de-recognition of a financial asset, the difference between the carrying amount of the asset and the sum of the consideration received (including any new asset obtained less any new liability assumed) and any cumulative gain or loss that had been recognised in Other Comprehensive Income ("OCI") is recognised in the income statement.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expired.

### *7.9.5. Offsetting financial assets and financial liabilities*

The Group receives and gives collateral in the form of cash in respect of its derivative transactions which are entered into under International Swaps and Derivatives Association (ISDA) master netting agreements. Under the ISDA, the parties to the agreement have a right of set off collateral against recognised amounts, which only becomes enforceable following an event of default, insolvency or bankruptcy of the Group or the counterparties or following other predetermined events, and as such these agreements do not meet the criteria for offsetting in the statement of financial position as per IAS 32.

In addition, the Group and its counterparties do not intend to settle on a net basis or to realise the assets and settle the liabilities simultaneously. As such cash collateral pledged is held within Loans and advances to banks and cash collateral received is held within other creditors in the statement of Financial Position.

## 7.10. Modification of financial assets and financial liabilities

If the terms of a financial asset are modified, then the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised, and a new financial asset is recognised at fair value plus any eligible transaction costs.

## 7.11. Impairment

The impairment model in IFRS 9 is an expected credit loss model, which means that it is not necessary for a loss event to occur before an impairment loss is recognised. The impairment allowance is more forward-looking.

The impairment requirements apply to all financial assets at amortised cost, debt financial assets at FVOCI and loan commitments but not those measured at FVTPL (some Development Finance loans as mentioned above).

IFRS 9 requires assets to be classified into three stages. The Group applies this three-stage approach to measuring the expected credit loss (ECL) based on credit migration between the stages.

| | |
|---|---|
| **Stage 1** | Financial assets determined to have low credit risk at the reporting date, financial assets that have not had a significant increase in credit risk since initial recognition or that have low credit risk at the reporting date. For these assets, 12-month expected credit losses (ECL) are recognised and interest revenue is calculated on the gross carrying amount of the asset. 12-month ECL are the expected credit losses that result from default events that are possible within 12 months after the reporting date. |
| **Stage 2** | Financial assets that have experienced a significant increase in credit risk since initial recognition, are placed on the Group's Watchlist, are in Forbearance but still performing or trigger the 30 days past due backstop. For these assets, lifetime ECL are recognised, but interest income is still calculated on the gross carrying amount of the asset. Lifetime ECL are the expected credit losses that result from all possible default events over the expected life of the financial asset. |
| **Stage 3 & Stage 3 POCI** | Financial assets that have defaulted and are otherwise considered to be credit impaired, including having triggered the 90 days past due backstop. For these assets, specific impairment provisions will be raised where there is a reasonable expectation of an actual or potential loss. Interest income is calculated on the net carrying amount.<br><br>**Purchased or originated credit impaired (POCI)**<br><br>Acquired loans that meet the Group's definition of default at acquisition are treated as POCI assets. These assets attract a lifetime ECL allowance over the full term of the loan, even when these loans no longer meet the definition of default post acquisition. The Group does not originate credit-impaired loans. |

### *7.11.1. Significant estimates: ECL*

IFRS 9 impairment involves several important areas of judgement, including estimating forward looking modelled parameters, developing a range of unbiased future economic scenarios, estimating expected lives and assessing significant increases in credit risk, based on the Group's experience of managing credit risk.

Stages 1 and 2 ECLs as defined in the accounting policy are the product of the ECL model. Model governance, including validation both at inception and periodically, manual overlays, inputs and outputs, is covered by the Model Governance Committee.

Stage 3 impairments are assessed manually. Loans move to stage 3 when a specific event has occurred where there is objective evidence of impairment. In any case, the back-stop position is loans that are in default (90 days+ past due) automatically go into stage 3. When determining specific provisions and recoverability, macro-economic assumptions will also be taken into account.

### *7.11.2. Measurement of ECL/ECL Model*

ECL are a probability-weighted estimate of credit losses. Credit losses are the expected cash shortfalls from what is contractually due over the expected life of the financial instrument, discounted at the original effective interest rate. The impairment model calculates ECL at an individual loan level by multiplying probability of default (PD), loss given default (LGD) and the exposure at default (EAD). These variables are derived from internally developed statistical models adjusted to reflect forward looking information and are discussed below. Management adjustments are made to modelled output to account for situations where known or expected risk factors have not been considered in the modelling process. The recognition and measurement of ECL is highly complex and involves the use of significant judgement and estimation. This includes the formulation and incorporation of multiple forward-looking economic conditions into ECL to meet the measurement objective of IFRS 9.

| | |
|---|---|
| **PD** | PD represents the likelihood of a customer defaulting on their loan. The 12-month PD is either taken from a point-in-time reporting or application PD model or manually assessed via the 'Watch' process. PD models utilise qualitative and quantitative factors that are indicative of the risk of default e.g. arrears status and loan applications scores. This is then extrapolated using historic industry data, where available, or expert judgement to calculate the lifetime PD. The lifetime PD is calculated on a weighted basis across all scenarios.<br><br>These factors vary for each loan portfolio. Exposures are subject to ongoing monitoring, which may result in an exposure being moved to a different credit risk grade. The forecast changes in economic conditions are considered for all portfolios.<br><br>As the Group's performance data does not go back far enough to capture a full economic cycle, the Group selected a proxy series that best represents each business line to build economic response models ('ERM') to capture the effects of a recession. For Asset Finance and Block Discounting it is the Finance and Leasing Association's Business Finance Balances in Arrears; for Development Finance it is the Bank of England's Write-offs of Lending to Companies Involved in the Development of Buildings; and for Specialist Mortgages it is UK Finance's Mortgages Over Three Months in Arrears for the Buy-to-Let Market. For the Other Commercial and Acquisition Finance portfolios this is the ONS published Company Insolvencies; and for Retail Finance it is the Other Personal Lending Bank Balance Write-offs published by the Bank of England. |
| **EAD** | EAD is based on the amount expected to be owed at default over the next 12 months (stage 1 accounts) or over the remaining lifetime (stage 2 accounts). EAD represents the expected exposure in the event of a default. EAD is derived from the current exposure and potential changes to the current amount allowed under the terms of the contract, including amortisation, overpayments and early terminations.<br><br>The EAD of a financial asset is its gross carrying amount. For loan commitments, the EAD includes the amount drawn as well as potential future amounts that may be drawn under the terms of the contract, estimated based on historical observations and forward-looking forecasts. |
| **LGD** | LGD is the magnitude of the likely loss in the event of default. This takes into account recoveries either through curing or, where applicable, through auction sale of repossessed collateral and debt sale of the residual shortfall amount. For loans secured by property and property developments, loan to value ('LTV') and gross development values ('GDV') ratios are key parameters in determining LGD. LGDs are calculated on a discounted cash flow basis using the financial instrument's effective interest rate origination as the discount factor. |

### *7.11.3. Significant judgment and estimates: Determining a significant increase in credit risk since initial recognition*

The impairment model utilises both relative and absolute criteria to identify increases in credit risk:

- Loans 30 days past due but with less than 90 days of arrears.
- Loans moved to the Watchlist. Numerous quantitative and qualitative watch list factors are monitored including changes in bureau behavioural score, formal credit actions (e.g. winding up orders, CCJs, meeting of creditors), changes in customer behaviour, and requests for payment holidays, adverse changes in financial performance, significant changes in Directors and cost over runs and timing delays experienced by borrowers. Current and forecast adverse changes in the customer's geography and sector are also considered.
- Deterioration of lifetime PD since origination (by a term-dependent relative threshold for AF and SM, doubling or increasing by 5% i.e. +500bps for DF and the majority of accounts to BD counterparty). In addition, for all portfolios, these increases are subject to a de minimis floor to ensure that the accounts with the lowest credit risk do not move into stage 2 due to a minimal change in the absolute level of PD. For all portfolios this threshold is 1%.

Due to a lack of historic trading data, the Group's stage transition criteria were set using industry level data and expert judgement. Going forward the criteria will be refined once sufficient HTB specific credit data is available and the Group can further develop its quantitative tests.

### *7.11.4. Definition of default and credit impaired assets*

A financial asset is credit impaired (or defaulted) when an event or events that have a detrimental impact on estimated future cash flows have occurred. The triggers that will help identify this are explained below.

Loan accounts are classified as in default if any of the following criteria has been met:

- 90 days past due.
- Customer is bankrupt, in administration or liquidation.
- Significant decline in the credit quality of a credit obligation.
- Material breach of documented terms and conditions which the Group has considered appropriate to enforce.
- Stage 3 exposures.
- Forborne non-performing exposures.
- Sale of credit obligations (not currently done by the Group).
- Distressed restructuring.

The definition of default largely aligns with that applied by the Group for regulatory capital purposes.

### *7.11.5. Forecast economic data*

IFRS 9 requires ECL to reflect a range of possible outcomes and to consider future economic conditions. The Group incorporates forward looking information into both its assessment of whether the credit risk of a financial asset has increased significantly since initial recognition and its measurement of ECL. This is achieved by developing a number of potential economic scenarios and modelling ECL for each scenario. The outputs from each scenario are combined using the estimated likelihood of each scenario occurring to derive a probability-weighted expected credit loss. The scenarios adopted and probability weighting applied are approved by the Model Governance Committee and then submitted to the Audit Committee as part of year end approval.

To achieve this the model uses five economic forecasts: one base; two upside; and, two downside scenarios. All the scenarios have been sourced from an independent economic consultancy, Oxford Economics. The upside and downside scenarios are calculated from a range of economic variables that are stressed around the base case. The ECL recognised in the financial statements reflects the effect on expected credit losses of a range of possible outcomes, calculated on a probability-weighted basis, based on the economic scenarios described above. The probability-weighted amount is typically a higher number than would result from using only the base economic scenario. Credit losses and defaults typically have a non-linear relationship to the many factors which influence credit losses, such that more favourable macroeconomic factors do not reduce expected losses as much as less favourable macroeconomic factors increase expected losses.

### *7.11.6. Movement between stages*

Watch lists will be reviewed regularly by the Head of Business Support to ensure that the strategies remain appropriate and up to date. Performing assets which have experienced a significant increase in credit risk since initial recognition are reclassified from Stage 1 (12 month ECL) to Stage 2 (lifetime ECL).

A renegotiated loan is derecognised, and a new agreement is made on a substantially different term. These renegotiated loans are classified as modified loans and can be transferred out of Stage 3 if they no longer exhibit evidence of being credit impaired. The decision to move a customer from 'Watch' to 'Performing' status can only be made by an individual/committee with the correct level of authority as per the Group's Delegated Authorities.

### *7.11.7. Cure methodology*

The credit risk of a financial asset may improve such that it is no longer considered to have experienced a significant increase in credit risk if it meets the Group's cure methodology.

The Group's cure methodology for all portfolios requires sufficient payments to be made to bring an account back within less than 30 days past due and for such payments to be maintained for two consecutive months.

To comply with IFRS 9 a customer will remain in default for 90 days even if cured. There is a 3-month probation period for both Stage 2 and 3 (except for loans under distressed restructuring that require a 12 month probation period). This also includes accounts that are removed from the watch list. Stage 3 loans can be moved to Stage 2 only on the basis of further analysis of the borrower's financial situation and the Group is satisfied about the likelihood of full and timely repayment of the exposure.

### *7.11.8. Write-off*

Loans and debt securities are written off (either partially or in full) when there is no reasonable expectation of recovering a financial asset in its entirety or a portion thereof. This is generally the case when the Group determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. This assessment is carried out at the individual asset level.

Recoveries of amounts previously written off are recognised when cash is received and are included in 'impairment losses on financial instruments' in the statement of comprehensive income and OCI.

### *7.11.9. Definition of Forbearance*

Forbearance is deemed to arise where the Group agrees, either formally or informally, to vary the contractual terms of a Credit Facility Agreement, prompted by:

- Current or anticipated financial difficulty of the borrower.
- Where concessions provided by the Group would not otherwise have been considered.

Forbearance is a qualitative Stage 2 trigger (as mentioned above).

### *7.11.10. Governance*

Stages 1 and 2 ECLs are the product of the ECL model. Model governance, including validation both at inception and periodically, monitoring, manual overlays, inputs and outputs, is covered by the Model Governance Committee.

Stage 3 impairments are assessed manually. Loans move to Stage 3 when a specific event has occurred where there is objective evidence of impairment. In any case, the back-stop position is loans that are in default (90 days+ past due) automatically go into Stage 3. When determining specific provisions and recoverability, macro-economic assumptions will also be taken into account.

The Credit Risk Management Framework is a key component of the RMF linking together the requirements for all the Group's credit related policies, procedures and practices and setting out how the Group will develop, implement, monitor and review credit risk. The Board sets its Risk Appetite in respect of Credit Performance and Stewardship, Credit Quality and Credit Concentration and monitors adherence to Risk Appetite using a suite of Risk Appetite Metrics which are reviewed by Board each month. All aspects of credit risk management including maintenance of appropriate frameworks and policies are subject to review by Credit Committee under direct report to Board Risk Committee.

Performance of the loan book is monitored and reported by the 2nd Line Risk Credit Analytics Team, working closely with the Group's Models Credit Risk Team who manage the Group's IFRS9 credit grading and loss models.

The Group has also introduced a stand-alone 2nd Line Business Support and Recoveries unit reporting direct to the Chief Risk Officer, independent of the 2nd Line Credit Risk Team. This unit manages all credit distressed customers with a view to supporting them to return to good health or seek alternative resolution to problem debt management.

All default accounts will be reviewed by the appropriate Delegated Authority holder or Credit Committee on a regular basis (quarterly as a minimum) and monitored monthly via risk data reporting packs. Any adjustment to the level of the provision will be subject to approval at the appropriate Delegated Authority level.

The Group manages its Model Risk through the Model Governance Committee ('MGC'). The committee is chaired by the CFO and is made up of the CRO, CCO, Director of Credit Analytics and Validation and Head of Models Credit Risk. The purpose of this committee is:

- To develop and recommend a framework comprising a set of model governance principles, policies, standards, and practices (including independence standards) that optimally support the Group's strategic priorities in accordance with the delegations under the Group's Schedule of Policies and Frameworks.
- To ensure that there is robust ongoing monitoring, challenge and assessment of all Models within the Group's business, including the monitoring of both Credit and Finance models.
- To oversee actions necessary to ensure the Group's Model Governance is adhered.
- To provide a quarterly summary of progress from the MGC including completed actions to the Audit Committee.

### 7.12. Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between markets participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Group has access at that date.

When one is available, the Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as "active" if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument on initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Group determines that the fair value on initial recognition differs from the transaction price, and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability, nor based on a valuation technique for which any unobservable inputs are judged to be insignificant in relation to the measurement, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value on initial recognition and the transaction price. Subsequently that difference is recognised in the income statement on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

### *7.12.1. Significant estimates*

The Group measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements

- **Level 1:** Inputs that are quoted market prices (unadjusted) in active markets for identical instruments.
- **Level 2:** Inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.
- **Level 3:** Inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Valuation techniques include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis. The objective of valuation techniques is to determine the fair value of the financial instrument at the reporting date as the price that would have been agreed between active market participants in an arm's length transaction.

The Group uses widely recognised valuation models to determine the fair value of common and simple financial instruments, such as interest rate swaps, that use only observable market data and require little management estimation. Observable prices and model inputs are usually available in the market for listed debt securities and simple over the counter derivatives such as interest rate swaps. The availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values.

The availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

For more complex instruments, the Group uses proprietary valuation models, which are developed from recognised valuation models. Some or all of the significant inputs into these models may not be observable in the market and may be derived from market prices or rates or estimates based on assumptions. Examples of instruments involving significant unobservable inputs include certain loans and advances. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in the determination of fair value. Management judgement and estimation are usually required for determination of timing and size of cash flows, probability of counterparty default and selection of appropriate discount rates.

Fair value estimates obtained from models are adjusted for any other factors such as liquidity risk and model uncertainties to the extent the Group believes a third-party market participant would take them into account in pricing a transaction. Fair values reflect the credit risk of the instrument.

### 7.13. Loans and advances to banks

Cash and cash equivalents comprise loans and advances to banks and building societies. Loans to banks and building societies comprise cash balances and call deposits.

### 7.14. Derivatives held for risk management purposes and hedge accounting

The Group designates certain derivatives as hedging instruments in respect to interest rate risk in fair value and cash flow hedges. The Group applies hedge accounting for portfolio hedges of interest rate risk. The hedged items are portfolios that are identified as part of the risk management process. The Group uses the exemption to continue using IAS 39 hedge accounting.

At the inception of the hedge relationship, the Group documents the relationship between the hedging instrument and the hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instrument is effective in offsetting changes in fair values of the hedged item attributable to the hedged risk, which is when the hedging relationships meet all of the following hedge effectiveness requirements:

- There is an economic relationship between the hedged item and the hedging instrument.
- The effect of credit risk does not dominate the value changes that result from that economic relationship.
- The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Group actually hedges and the quantity of the hedging instrument that the Group actually uses to hedge that quantity of hedged item.

The Group rebalances a hedging relationship in order to comply with the hedge ratio requirements when necessary. In such cases discontinuation may apply to only part of the hedging relationship. For example, the hedge ratio might be adjusted in such a way that some of the volume of the hedged item is no longer part of a hedging relationship, hence hedge accounting is discontinued only for the volume of the hedged item that is no longer part of the hedging relationship.

If a hedging relationship ceases to meet the hedge effectiveness (80-125%) requirement relating to the hedge ratio but the risk management objective for that designated hedging relationship remains the same, the Group adjusts the hedge ratio of the hedging relationship (i.e. rebalances the hedge) so that it meets the qualifying criteria again.

#### *7.14.1. Fair value hedges*

The Group applies fair value hedge accounting for portfolio hedges of interest rate risk. As part of its risk management process, the Group identifies portfolios whose interest rate risk its wishes to hedge. The portfolio comprise either only assets or only liabilities. The Group analyses each portfolio into repricing time periods based on expected repricing dates, by scheduling cash flows into the periods in which they are expected to occur.

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect profit or loss, changes in the fair value of the derivative are recognised immediately in profit or loss. The change in fair value of the hedged item attributable to the hedged risk is recognised in profit or loss. If the hedged item would otherwise be measured at cost or amortised cost, then its carrying amount is adjusted accordingly.

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively.

Any adjustment up to the point of discontinuation to a hedged item is amortised to income statement on a straight line basis over its remaining life.

On hedge discontinuation, any hedging adjustment made previously to a hedged financial instrument for which the effective interest method is used is amortised to income statement by adjusting the effective interest rate of the hedged item from the date on which amortisation begins. If the hedged item is derecognised, then the adjustment is recognised immediately in profit or loss when the item is derecognised.

In 2019 HTB established a LIBOR Transition Steering Committee, chaired by the CFO and reporting to the Board, which, during 2020 and 2021, has overseen the cessation of all new LIBOR business, the transfer of all LIBOR-linked derivatives to SONIA and the transition of LIBOR-linked or LIBOR reverting loans to an alternative benchmark. As at 30 November 2021, HTB had managed to transition all LIBOR-referencing loans with the exception of £124m of 'tough-legacy' balances that continue to reference LIBOR. In addition, the Group has £567m of fixed rate loans which include a reversionary rate tied to LIBOR (although it should be noted that our experience is only a very small percentage of these fixed rate mortgages are expected to revert to a floating rate). At the end of 2021, the Group had successfully transitioned all derivatives to SONIA.

During 2021 the FCA and HMT introduced what is widely known as 'tough legacy' provisions. These provisions apply to customer contracts referencing LIBOR whereby banks have not been able to transition the accounts to an alternative reference rate despite concerted efforts to do so. The legislation means that LIBOR-referencing contracts can continue to perform into 2022 past the cessation of LIBOR. This is achieved by replacing the definition and calculation of LIBOR to one based on SONIA. This is commonly referred to as 'synthetic LIBOR' and requires no adjustment to customer contracts. The tough legacy provisions expired at the end of 2022 and therefore HTB will continue to seek to actively transition as many contracts as possible during 2023.

The Group has concluded that as at 31 December 2022, its fair value relationships are no longer subject to uncertainty driven by the IBOR reform.

Accordingly, the Group ceased to apply the assumptions that the hedged benchmark interest rate, the cash flows of the hedged item and hedging instrument are not altered as a result of IBOR reform when the uncertainty arising from IBOR reform was no longer present.

### *7.14.2. Cash flow hedges*

The Group uses pay fixed/receive floating interest rate to hedge the interest rate risks in respect of the benchmark interest rate (mainly SONIA). The Group hedges interest rate risk to the extent of benchmark interest rate exposure on its floating-rate notes to mitigate variability in its cash flows. Hedge accounting is applied where economic hedging relationships meet the hedge accounting criteria.

The Group determines whether an economic relationship exists between the cash flows of the hedged item and hedging instrument based on an evaluation of the qualitative characteristics of these items and the hedged risk that is supported by quantitative analysis. The Group considers whether the critical terms of the hedged item and hedging instrument closely align when assessing the presence of an economic relationship. The Group evaluates whether the cash flows of the hedged item and the hedging instrument respond similarly to the hedged risk, such as the benchmark interest rate.

The Group further supports this qualitative assessment by using the dollar offset method to assess whether the hedging instrument is expected to be and has been highly effective in offsetting changes in the present value of the hedged item.

When a derivative is designated as the hedging instrument in a hedge of variability in cash flows attributable to a particular risk associated with a recognised asset or liability or highly probably forecast transaction that could affect profit or loss, the effective portion of changes in the fair value of the derivative is recognised in OCI and presented in the hedging reserve within equity. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss. The amount recognised in the hedging reserve is reclassified from OCI to profit or loss as a reclassification adjustment in the same period as the hedged cash flows affect profit or loss, and in the same line item in the statement of profit or loss and OCI.

If the hedging derivative expires or is sold, terminated and exercised, or the hedge no longer meets the criteria for cash flow hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively. However, if the hedged cash flows are no longer expected to occur, then the amount accumulated in the hedging reserve is reclassified from OCI to profit or loss immediately, if the hedged cash flows are expected to affect profit or loss in multiple reporting periods, then the Group reclassifies the amount in the hedging reserve from OCI to profit or loss on straight line basis.

## 7.15. Property, Plant and Equipment

Tangible fixed assets are stated at historical cost, which includes direct and incremental acquisition costs less accumulated depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of plant and equipment at the following rates:

- Office equipment 10% - 33%
- Fixtures and fittings 10% - 33%
- Equipment for hire 25% - 50%
- Leasehold Improvements 25% - 50%

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted accordingly with any adjustments made prospectively.

### *7.15.1. Subsequent costs*

Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Group. Ongoing repairs and maintenance are expensed as incurred.

### *7.15.2. Impairment of Property, Plant and Equipment*

At each balance sheet date property, plant and equipment are assessed for indications of impairment. If indications are present, these assets are subject to an impairment review. The impairment review comprises a comparison of the carrying amount of the asset with its recoverable amount which is the higher of the asset's net selling price and its value in use.

The carrying values of fixed assets are written down by the amount of any impairment and this loss is recognised in the income statement in the period in which it occurs. A previously recognised impairment loss relating to a fixed asset may be reversed in part or in full when a change in circumstances leads to a change in the estimates used to determine the fixed asset's recoverable amount.

The Group Leases office premises and these are presented as Right-of-Use assets on a separate line in the statement of financial position.

## 7.16. Intangible assets

Purchased software and costs directly associated with the internal development of computer software are capitalised as intangible assets where the software is an identifiable asset controlled by the Group which will generate future economic benefits and where costs can be reliably measured. They are stated at historical cost.

Amortisation begins when the asset becomes available for operational use and is charged to the income statement on a straight-line basis over the estimated useful life of the software, which is generally between 3 to 7 years. The amortisation periods used are reviewed annually.

#### *7.16.1. Subsequent costs*

Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense as incurred. Intangible assets are stated at cost less cumulative amortisation and impairment losses.

Assets are reviewed for impairment at each statement of financial position date or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount, if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell, and its value in use.

### 7.17. Deposits

Customer deposits are non-derivative financial liabilities with fixed or determinable payments. Deposits are initially measured at fair value less incremental direct transaction costs. Subsequently, they are measured at amortised cost using the effective interest rate method.

Funding is raised from customers depositing money in their savings accounts and central bank facilities. These funds are then used to lend to customers. To ensure the Group has sufficient cash to repay customers when required, we are required to hold a minimum level of liquid assets. The Group's Treasury team manage the level of liquid assets and funding to ensure we meet the demands of customers, creditors and regulators.

### 7.18. Financial liabilities - Central Bank Facilities

Loans and advances over which the Group Bank transfers its rights to the collateral thereon to the Bank of England under the Term Funding Scheme with Additional Incentives for SMEs (TFSME) and Indexed Long-term Repo Scheme (ILTR) are not derecognised from the Statement of Financial Position as the Group retains substantially all the risks and rewards of ownership including all cash flows from the loans and advances and exposure to credit risk.

Financial liabilities are initially measured at fair value and are subsequently measured generally at amortised cost unless it is held for trading. A financial liability will be derecognised when it is discharged or cancelled or expired. Financial liabilities are subsequently measured at amortised cost, interest is accrued over the life of the agreement on an EIR basis.

Drawings under the TFSME have a maturity of four years and bear interest at Bank Base Rate. Drawings under the scheme are collateralised using the Group's loan portfolio and are measured at amortised cost. The volume of funding which can be drawn through central bank facilities is restricted by the volume of assets which the Group is willing to encumber in the schemes. The Group has set its risk appetite for asset encumbrance to ensure that the Group is able to utilise central bank facilities as much as possible, whilst ensuring sufficient availability of 'free' assets, (assets that are unencumbered but that may be encumbered).

Drawings under ILTR have a much shorter maturity date and a rate of interest set in auction process. The Group regularly monitors the level of encumbrance to ensure it is in line with the above approved internal risk appetite limits.

The Group regularly monitors the level of encumbrance to ensure it is in line with the above approved internal risk appetite limits.

### 7.19. Subordinated liabilities

Subordinated liabilities are initially measured at fair value minus incremental direct transaction costs.
These instruments are subsequently stated at amortised cost using the effective interest rate method.
The subordinated Tier 2 notes are eligible for treatment as regulatory capital. During 2022 the notes paid interest at a rate of 7.25% per annum, payable semi-annually in arrears. The notes mature on 10 May 2028.

### 7.20. Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that the outflow of the economic benefits will be required to settle the obligation.

Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognised as interest expense.

Provision for bank levies is recognised when the condition that triggers the payment of the levy is met. If the levy is subject to a minimum activity threshold, then a provision is recognised when that minimum activity of threshold is reached.

### 7.21. Financial guarantees and loan commitments

The Group is the holder of a guarantee offered by the Secretary of State for Business, with the British Business Bank acting as agent.

During 2020 and 2021, the Group entered the Coronavirus Business Interruption Loan Scheme (CBILS) with the British Business Bank. The scheme is in place with Asset Finance and helps provide funding to SMEs who have been adversely effected by the Covid-19 pandemic. The key attributes of the scheme are that the UK Government pays the first 12 months interest for the customer and provide 80% coverage on any losses incurred for loans within the scheme.

During 2021, the Recovery Loan Scheme (RLS) was announced by HM Treasury on 3 March 2021, available after 6 April 2021. RLS provides lenders with a government-backed guarantee of 80% on losses that may arise on facilities of above £25,000 (£1,000 for asset finance) up to £10 million.

Financial guarantee contracts held are recognised as an asset equal to the prepayment of the premium paid and the asset is amortised to profit and loss over the period in which benefit of the guarantee is obtained.

### 7.22. Shareholders’ funds

The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Where an instrument contains no obligation on the Group to deliver cash or other financial assets, or to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavourable to the Group, or where the instrument will or may be settled in the Group’s own equity instruments but includes no obligation to deliver a variable number of the Group’s own equity instruments, then it is treated as an equity instrument. Accordingly, the Group’s share capital is presented as components of equity. Any dividends, interest or other distributions on capital instruments are also recognised in equity. Any related tax is accounted for in accordance with IAS 12.

### 7.23. Other equity instruments

Capital securities are classified as equity instruments, as the substance of the contractual arrangements are such that there is no present obligation to deliver cash, another financial asset or a variable number of equity instruments. The capital securities are measured at fair value of the proceeds from the issuance less any costs that are incremental and directly attributable to the issuance (net of applicable tax).

Distributions to holders of the capital securities are recognised when they become irrecoverable and are deducted from retained earnings in equity.

## 8. Interest income and expense

See accounting policies in notes 7.1 and 7.3.

| | Note | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|---|
| Interest and similar income on Loans and Advances to Customers held at amortised cost | | 137,584 | 118,763 | 85,772 |
| Interest and similar income on Loans and Advances to Customers held at fair value through profit and loss | | 1,095 | 1,095 | 2,451 |
| Interest on Loans and Advances to Banks | | 4,389 | 4,323 | 174 |
| Interest on Investment Securities | | 3,257 | 2,744 | 111 |
| Interest on intercompany loans | | - | 7 | - |
| Interest received on Derivative Financial Instruments | | 4,907 | 4,907 | - |
| **Total Interest receivable and similar income** | | **151,232** | **131,839** | **88,508** |
| Interest paid on Derivative Financial Instruments | | - | - | (3,993) |
| Interest on Deposits from Customers, TFSME & ILTR | | (37,619) | (30,940) | (13,105) |
| Interest on Subordinated Liabilities | | (2,315) | (2,315) | (2,253) |
| **Total Interest expense and similar charges** | | **(39,934)** | **(33,255)** | **(19,351)** |
| **Net Interest Income** | | **111,298** | **98,584** | **69,157** |

## 9. Fees and commission income and expense

See accounting policy in note 7.2.

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Operating Lease Income | 1,646 | - | - |
| **Total Operating Lease Income** | **1,646** | **-** | **-** |
| Facility Fees | 421 | 382 | 389 |
| Early Settlement Fees | 1,655 | 1,541 | 615 |
| Customer Service Fees | 177 | 155 | 98 |
| Commitment Fees on Development Finance Loans | - | - | 431 |
| Brokerage Fees | 852 | - | - |
| **Fees and Commission Income** | **3,105** | **2,078** | **1,533** |
| Bank Charges | (1,305) | (1,330) | (603) |
| Credit and Identity Searches | (385) | (307) | (202) |
| **Fees and Commission Expense** | **(1,690)** | **(1,637)** | **(805)** |

Fees and commission income for the Bank and the Group include £Nil of commitment fees charged for Development Finance loans held at FVTPL which under IFRS 9 is recognised upon receipt (2021: £431k).

## 10. Net gain or loss on financial assets at fair value through P&L

See accounting policy in note 7.3.

| Group and Bank | Note | 2022 £000 | 2021 £000 |
|---|---|---|---|
| Derivatives held for risk management excluding the effective portion of derivatives held for hedge accounting purposes: | | | |
| Interest rate risk | **20/21** | 3,260 | 2,813 |
| Gain/ (Loss) on loans and advances to customers held at FVTPL | **22** | 16 | 362 |
| **Net gain on loans and other financial assets at FVTPL** | | **3,276** | **3,175** |

## 11. Other income

| Group and Bank | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Foreign exchange gains | (2) | (2) | 9 |
| Management recharges | – | 6,514 | – |
| **Other Income** | **(2)** | **6,512** | **9** |

Small foreign exchange gains and losses occasionally arise due to timing difference in the exchange rates when the Group acquires assets for its finance leasing activity from international suppliers. All loans to customers and financial institutions are denominated in pounds sterling.

Management recharges of £6.5m relate to transition costs incurred in the integration of systems and processes into the Bank's operational infrastructure following the acquisition of subsidiaries during the year, and staff costs related to ongoing management activities.

## 12. Administration Expenses

| | Note | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|---|
| Depreciation and amortisation | 30/31/32 | 7,314 | 4,411 | 3,936 |
| Staff Costs | 13 | 38,845 | 34,928 | 26,376 |
| Share based payments | 14 | 240 | 240 | 676 |
| Other Administrative expenses | | 23,482 | 17,405 | 15,325 |
| **Administrative Expenses** | | **69,881** | **56,984** | **46,313** |

Included within Administrative expenses are £2.6m staff costs and £3.9m of other administrative expenses subject to management recharges to subsidiary undertakings as recognised through other income (note 11).

## 13. Staff numbers and costs

See accounting policy in note 7.4.

The average number of persons employed by the Group (including directors) during the year was as follows:

| | Group 2022 | Bank 2022 | Group and Bank 2021 |
|---|---|---|---|
| Directors | 8 | 8 | 7 |
| Lending | 152 | 141 | 120 |
| Administrators | 235 | 173 | 132 |
| | **395** | **322** | **259** |

The analysis includes both full-time and part-time staff including Non-Executive directors.

The aggregate payroll costs of these people were as follows:

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Wages and Salaries | 32,993 | 29,848 | 22,661 |
| Social Security costs | 4,286 | 3,880 | 2,849 |
| Pension costs | 2,069 | 1,836 | 1,372 |
| Other staff costs | 1,203 | 1,070 | 871 |
| | **40,551** | **36,634** | **27,753** |
| Of which capitalised as Intangible Assets | 1,706 | 1,706 | 1,377 |
| Of which included within Administration Expenses | 38,845 | 34,928 | 26,376 |
| | **40,551** | **36,634** | **27,753** |

**Directors remuneration:**

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Directors' Salaries and Bonus | 1,408 | 1,387 | 1,481 |
| Directors' Share based payments | 95 | 95 | 267 |
| | **1,503** | **1,482** | **1,748** |

There were no directors to whom retirement benefits were accruing in respect of qualifying services during the year (2021: nil).

There were no directors in respect of whose qualifying services shares were received or receivable under long term incentive schemes during the year (2021: nil).

The aggregate of emoluments of the highest paid director of the Group was £594k (2021: £667k). No pension costs were attributable to the highest paid director and no shares were received or receivable by that director in respect of qualifying services under a long term incentive scheme.

During 2022, Remuneration for Non-Executive directors of the Group consisted of payments of £481k. Remunerations for Non- Executive directors of the bank totalled £360k (2021: £355k).

## 14. Employee share-based payment transactions

See accounting policy in note 7.5.

Details of shares issued are shown in the table below:

| Group and Bank | 2022 No. of Shares | 2021 No. of Shares |
|---|---|---|
| At 1 January | 5,999 | 1,944 |
| Granted | 200 | 4,555 |
| Forfeited | (450) | (500) |
| At 31 December | **5,749** | **5,999** |

The average fair value of shares issued during the year was £991 per share (2021: £977).

The charge to the Consolidated Income Statement was a debit of £240k (2021: £676k).

## 15. Auditor's remuneration

| | 2022 £000 | 2021 £000 |
|---|---|---|
| Audit of these financial statements | 1,513 | 924 |
| Other services: | | |
| Audit of subsidiaries | 693 | - |
| Audit-related assurance services | 88 | 75 |
| Other non-audit services | - | 89 |
| Total other services | 781 | 164 |
| | **2,294** | **1,088** |

## 16. Dividends received

| | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|
| Dividend received | 20,000 | - |
| | **20,000** | **-** |

During 2022 a dividend was paid by Wesleyan Bank Limited of £20m (2021: £Nil)

## 17. Taxation

See accounting policy in note 7.7.

| Recognised in the Statement of Comprehensive Income | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Current tax on profits for the year | 10,960 | 11,341 | 7,652 |
| Adjustment in respect of prior years | (239) | (239) | - |
| Total current tax | **10,721** | **11,102** | **7,652** |
| *Deferred tax:* | | | |
| Origination and reversal of temporary differences | (657) | (777) | (388) |
| Adjustments in respect of prior periods | 216 | 224 | - |
| Effect of tax rate change on opening balance | (7) | (61) | (480) |
| Total deferred tax charge/(credit) | (447) | (614) | (868) |
| Tax on profit/(loss) on ordinary activities | **10,274** | **10,488** | **6,784** |

| Tax reconciliation | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Profit for the year | 88,359 | 64,521 | 27,346 |
| Tax using the UK corporation tax rate of 19.00% (2021: 19.00%) | 16,789 | 12,259 | 5,196 |
| *Effects of:* | | | |
| Permanent non-deductible expenses | 356 | 459 | 1,224 |
| Effect of tax rate change on opening balance | (7) | (61) | (480) |
| Adjustment for prior year tax differences | (23) | (15) | - |
| Income not taxable | (8,784) | (4,097) | (8) |
| Effects of Group Relief/ other reliefs | (14) | (14) | (10) |
| Surcharge on banking companies | 1,957 | 1,957 | 862 |
| | **10,274** | **10,488** | **6,784** |

The corporation tax liability for the Group and the Bank at 31 December 2022 is £1,121k (2021: £4,277k). This is disclosed within other tax and social security in note 34 Other Liabilities.

## 18. Deferred Tax Asset (Liability)

Deferred tax assets (liabilities) are attributable to the following:

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Accelerated capital allowances | 8,768 | 2,545 | 1,838 |
| Short term timing differences | 58 | 58 | 169 |
| Tax losses carried forward and other deductions | 151 | - | - |
| IFRS 16 adjustment | 6 | 6 | 15 |
| IFRS 9 adjustment | 407 | (71) | (97) |
| **Deferred Tax Asset** | **9,390** | **2,538** | **1,925** |

The movement in deferred tax during the year is as follows:

| | 2022 £000 | 2022 £000 | 2021 £000 |
|---|---|---|---|
| Balance brought forward | 1,925 | 1,925 | 1,057 |
| Acquired as part of business combination | 7,018 | - | - |
| Adjustments in respect to the prior periods | (224) | (225) | - |
| Credit to the income statement | 671 | 838 | 868 |
| **Deferred Tax Asset** | **9,390** | **2,538** | **1,925** |

The Bank has calculated the UK deferred tax asset as at 31 December 2022 using a blended forecast future tax rate of 25.5% (2021: 29%). This blended rate is calculated based on the main rate of corporation tax enacted at the 31 December as well as an expectation that the Bank is not likely to be liable to pay banking surcharge tax from the following period due the de minimis raising to £100m with effect from 1 April 2023.

The deferred tax balance of the Group's consolidated subsidiaries relates to timing differences of fixed assets between depreciation and capital allowances, and the IFRS 9 transitional adjustment which is spread over 10 years in line with IFRS. The Group has calculated the UK deferred tax asset on subsidiary fixed assets as at 31 December 2022 using a blended forecast future tax rate of 24.73% (2021: 23.7%). This blended rate is calculated based on the main rate of corporation tax enacted at 31 December as well as an expectation that the Group will be able to utilise capital allowances in full each year. The IFRS 9 transitional adjustment will be released over 10 years in line with IFRS using a blended rate of 24.25%.

## 19. Loans and Advances to Banks

See accounting policy in note 7.9.

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Placements with other Banks included in Loans and Advances to Banks | | | |
| Repayable on demand | 462,609 | 458,974 | 242,323 |
| | **462,609** | **458,974** | **242,323** |

Included within loans to Banks and building societies is a balance held in the Bank of England reserve account of £452.1m (2021: £229.9m) and £3.6m restricted cash ratio deposits held with the Bank of England (2021: £1.1m).

The table below, excluding the Bank of England reserve account, presents an analysis of Loans and Advances to Banks and Building Societies by rating agency designation as at 31 December, based on Moody's long term ratings.

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Aa3 | 3,577 | 3,577 | 1,138 |
| A1 | 6,934 | 3,298 | 11,236 |
| | **10,511** | **6,875** | **12,374** |

## 20. Derivative financial instruments held for risk management

See accounting policy in note 7.14.

The Group holds derivative financial instruments in the normal course of its banking business for interest rate risk management and margin stabilisation purposes. The fair values and notional amounts of derivative instruments held for risk management purposes are presented in the following table:

| Group and Bank | Notional Amount £000 | Fair value of assets £000 | Fair value of liabilities £000 |
|---|---|---|---|
| **At 31 December 2022** | | | |
| ***Interest rate swaps:*** | | | |
| Designated in fair value hedges | 3,497,300 | 112,889 | 18,932 |
| Designated in cashflow hedges | 61,100 | 430 | 118 |
| Other risk management derivatives | 265,600 | – | 86 |
| | **3,824,000** | **113,319** | **19,136** |

| Group and Bank | Notional Amount £000 | Fair value of assets £000 | Fair value of liabilities £000 |
|---|---|---|---|
| **At 31 December 2021** | | | |
| ***Interest rate swaps:*** | | | |
| Designated in fair value hedges | 2,150,500 | 19,365 | 4,413 |
| Other risk management derivatives | 10,500 | 93 | – |
| | **2,161,000** | **19,458** | **4,413** |

Amounts recognised in the statement of profit and loss in respect of fair value gains and losses on hedged items and hedged instruments are as follows:

| Group and Bank | 2022 £000 | 2021 £000 |
|---|---|---|
| Net gain on derivatives designated as fair value hedges | 79,006 | 27,820 |
| Fair value adjustments from hedge accounting | (73,530) | (25,595) |
| **Ineffectiveness of fair value hedges** | **5,476** | **2,225** |
| Net (loss) on derivatives designated as cashflow hedges, realised through profit and loss. | (65) | – |
| Movements on other derivative financial instruments | (2,151) | 588 |
| **Fair value gains on derivative financial instruments** | **3,260** | **2,813** |

Details of derivatives designated as hedging instruments in qualifying hedging relationships are provided in in note 21. The Group uses other derivatives, not designated in a qualifying hedging relationship ('other risk management derivatives'), to manage its exposure to interest rate risk. The instruments used principally include interest rate swaps.

For more information about how the Group manages its market risks, see note 29.4.

## 21. Hedge accounting

### A. Fair value hedges of interest rate risk

See accounting policy in note 7.14.

At 31 December the maturities of interest rate swaps held by the Group as hedging instruments in fair value hedges of interest risk are as follows:

| As at 31 December 2022 | not more than 3 months £000 | over 3 but not more than 6 months £000 | over 6 but not more than 1 year £000 | over 1 but not more than 3 years £000 | over 3 but not more than 5 years £000 | over 5 but not more than 10 years £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| Nominal value of derivatives held for hedging purposes | 457,600 | 265,100 | 680,400 | 997,600 | 1,076,600 | 20,000 | 3,497,300 |
| Average fixed interest rate | 1.38% | 2.19% | 3.02% | 1.64% | 1.95% | 5.12% | 2.03% |

| As at 31 December 2021 | not more than 3 months £000 | over 3 but not more than 6 months £000 | over 6 but not more than 1 year £000 | over 1 but not more than 3 years £000 | over 3 but not more than 5 years £000 | over 5 but not more than 10 years £000 | Total £000 |
|---|---|---|---|---|---|---|---|
| Nominal value of derivatives held for hedging purposes | 83,100 | 218,700 | 369,300 | 713,000 | 749,400 | 17,000 | 2,150,500 |
| Average fixed interest rate | 0.66% | 0.48% | 0.46% | 0.55% | 0.39% | 0.98% | 0.49% |

The amounts relating to items designated as hedged items at 31 December were as follows:

| 31 December 2022 | Carrying amount 2022 | | Accumulated Fair value adjustments on the hedged item included in the carrying amount | | Line item in balance sheet | Change in value used for calculating hedge ineffectiveness |
|---|---|---|---|---|---|---|
| | Assets (FV) £000 | Liabilities (FV) £000 | Assets £000 | Liabilities £000 | | |
| Loans and advances | 1,462,292 | – | (101,262) | – | Loans and advances to customers | (84,630) |
| Customer deposits | – | 1,687,420 | – | 14,494 | Customer deposits | 11,100 |

| 31 December 2021 | Carrying amount 2022 | | Accumulated Fair value adjustments on the hedged item included in the carrying amount | | Line item in balance sheet | Change in value used for calculating hedge ineffectiveness |
|---|---|---|---|---|---|---|
| | Assets (FV) £000 | Liabilities (FV) £000 | Assets £000 | Liabilities £000 | | |
| Loans and advances | 1,084,771 | – | (16,631) | – | Loans and advances to customers | (30,791) |
| Customer deposits | – | 843,744 | – | 3,394 | Customer deposits | 5,196 |

## 21. Hedge accounting (continued)

The amounts relating to items designated as hedged instruments at 31 December were as follows:

| As at 31 December 2022 | Nominal amount £000 | Assets (carrying amount) £000 | Liabilities (carrying amount) £000 | Line item in balance sheet | Change in fair value £000 | Ineffective-ness | Line item in profit or loss |
|---|---|---|---|---|---|---|---|
| Interest rate swap – Hedge of loans and advances | | | | | | | |
| **Assets** | | | | | | | |
| Interest rate risk | 1,824,800 | 112,889 | - | Derivative assets held for risk management | 93,524 | 6% | Net (loss)/gain on loans and other financial assets at Fair value through profit and loss |
| Interest rate swaps - Hedge of customer deposits | | | | | | | |
| **Liabilities** | | | | | | | |
| Interest rate risk | 1,672,500 | - | 18,931 | Derivative Liabilities held for risk management | 14,518 | 0% | Net (loss)/gain on loans and other financial assets at Fair value through profit and loss |

| As at 31 December 2021 | Nominal amount £000 | Assets (carrying amount) £000 | Liabilities (carrying amount) £000 | Line item in balance sheet | Change in fair value £000 | Ineffective-ness | Line item in profit or loss |
|---|---|---|---|---|---|---|---|
| Interest rate swap – Hedge of loans and advances | | | | | | | |
| **Assets** | | | | | | | |
| Interest rate risk | 1,199,700 | 19,312 | - | Derivative assets held for risk management | 17,620 | 11% | Net (loss)/gain on loans and other financial assets at Fair value through profit and loss |

| As at 31 December 2021 | Nominal amount £000 | Assets (carrying amount) £000 | Liabilities (carrying amount) £000 | Line item in balance sheet | Change in fair value £000 | Ineffective-ness | Line item in profit or loss |
|---|---|---|---|---|---|---|---|
| Interest rate swaps - Hedge of customer deposits | | | | | | | |
| **Liabilities** | | | | | | | |
| Interest rate risk | 950,800 | - | 4,360 | Derivative Liabilities held for risk management | 10,200 | 4% | Net (loss)/gain on loans and other financial assets at Fair value through profit and loss |

## 21. Hedge accounting (continued)

### B. Cashflow hedges of interest rate risk

At 31 December the maturities of interest rate swaps held by the Group as hedging instruments in Cash flow hedges of exposures to interest rates are as follows:

| As at 31 December 2022 | over 5 but not more than 10 years £000 | Total £000 |
|---|---|---|
| Nominal value of derivatives held for hedging purposes | 61,100 | 61,100 |
| Average fixed interest rate | 3.91% | 3.91% |

The amounts relating to items designated as hedged instruments at 31 December were as follows:

| As at 31 December 2022 | Nominal amount £000 | Assets (carrying amount) £000 | Liabilities (carrying amount) £000 | Line item in balance sheet | Change in fair value £000 | Ineffective-ness | Line item in Profit and loss |
|---|---|---|---|---|---|---|---|
| Interest rate swap – Hedge of floating rate liabilities | | | | | | | |
| **Assets** | | | | | | | |
| Interest rate risk | 49,400 | 430 | - | Derivative assets held for risk management | 430 | 0% | Net (loss)/gain on loans and other financial assets at Fair value through profit and loss |
| **Liabilities** | | | | | | | |
| Interest rate risk | 11,700 | - | 118 | Derivative Liabilities held for risk management | 118 | 0% | Net (loss)/gain on loans and other financial assets at Fair value through profit and loss |

The amounts relating to items designated as hedged items at 31 December 2022 were as follows:

| 31 December 2022 | Line item in balance sheet | Change in value used for calculating hedge ineffectiveness | Cash flow hedge reserve | Balances remaining in cash flow hedge reserve from hedging relationships for which hedge accounting is no longer applied |
|---|---|---|---|---|
| Interest rate risk | Central Banking Facilities | 125 | 129 | 248 |

For more information about how the Group manages its market risks, see note 29.4.

## 22. Loans and advances to customers at FVTPL

See accounting policy in note 7.9.

The following table summarises the carrying values of financial assets presented on the Group's balance sheet and the fair value of these financial instruments.

| Group and Bank | 2022 £000 | 2021 £000 |
|---|---|---|
| **Development Finance** | **4,294** | **10,025** |

## 23. Loans and advances to customers at amortised cost

See accounting policy in note 7.9.

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| **Development Finance** | 224,639 | 224,639 | 148,749 |
| Less: allowance for impairment | (2,934) | (2,934) | (2,683) |
| | **221,705** | **221,705** | **146,066** |
| **Specialist Mortgages** | 1,710,267 | 1,710,267 | 1,314,350 |
| Less: allowance for impairment | (7,315) | (7,315) | (2,833) |
| | **1,702,952** | **1,702,952** | **1,311,517** |
| **Commercial and Retail Finance** | 283,146 | - | - |
| Less: allowance for impairment | (4,798) | - | - |
| | **278,348** | **-** | **-** |
| **Asset Finance** | | | |
| *Hire Purchase and Loans* | 329,113 | 214,366 | 140,947 |
| *Finance Leases* | 58,993 | 43,286 | 34,808 |
| Less: allowance for impairment | (5,975) | (4,113) | (5,655) |
| | **382,131** | **253,539** | **170,100** |
| **Wholesale finance** | 166,213 | 166,213 | 93,632 |
| Less: allowance for impairment | (24) | (24) | (1) |
| | **166,189** | **166,189** | **93,631** |
| | **548,314** | **419,728** | **263,731** |
| **Fair value adjustments from portfolio hedging** | **(101,262)** | **(101,262)** | **(16,631)** |
| | **2,650,063** | **2,243,123** | **1,704,683** |

## 23. Loans and advances to customers at amortised cost (continued)

### Hire Purchase and Loan

See accounting policy in note 7.6.

The table below provides an analysis of Hire Purchase and Loan receivables.

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Gross investment in hire purchase receivables: | | | |
| Year 1 | 116,278 | 75,656 | 61,494 |
| Year 2 | 100,541 | 65,380 | 39,193 |
| Year 3 | 74,451 | 49,792 | 28,204 |
| Year 4 | 46,579 | 33,924 | 18,211 |
| Year 5 | 23,381 | 17,716 | 10,939 |
| More than 5 years | 7,785 | 5,210 | 3,196 |
| Total future repayments | 369,015 | 247,678 | 161,237 |
| Unearned finance income | (39,902) | (33,312) | (20,290) |
| Net investment | 329,113 | 214,366 | 140,947 |
| Less impairment allowance | (3,835) | (2,972) | (4,098) |
| | **325,278** | **211,394** | **136,849** |

### Finance Lease Receivables

The table below provides an analysis of finance lease receivables for leases of equipment in which the Group is the lessor.

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Gross investment in finance lease receivables: | | | |
| Year 1 | 27,214 | 19,630 | 17,557 |
| Year 2 | 18,419 | 13,748 | 10,773 |
| Year 3 | 11,328 | 8,480 | 6,457 |
| Year 4 | 6,119 | 4,915 | 2,823 |
| Year 5 | 2,610 | 2,124 | 990 |
| More than 5 years | 356 | 16 | 158 |
| Total future repayments | 66,046 | 48,913 | 38,758 |
| Unearned finance income | (7,053) | (5,627) | (3,950) |
| Net investment in finance leases | 58,993 | 43,286 | 34,808 |
| Less impairment allowance | (2,140) | (1,141) | (1,557) |
| | **56,853** | **42,145** | **33,251** |

## 24. Investment securities held at amortised cost

See accounting policy in note 7.9.

The value of investment securities held at amortised cost as at 31 December is as follows:

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Covered bonds | 33,462 | 33,462 | 20,042 |
| Gilts | 228,913 | 184,260 | 176,670 |
| **Debt Securities** | **262,375** | **217,722** | **196,712** |

The following table sets out the credit quality of Investment Securities as at 31 December. The analysis has been based on Moody's long term ratings.

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| A1 | 252,582 | 207,929 | 190,937 |
| A2 | - | - | - |
| A3 | 9,793 | 9,793 | 5,775 |
| | **262,375** | **217,722** | **196,712** |

## 25. Central Bank Facilities

See accounting policy in note 7.18.

The balances arising from central bank facilities carried in the Bank's accounts are shown below:

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| TFSME | 393,049 | 295,000 | 295,000 |
| **Central Bank Facilities** | **393,049** | **295,000** | **295,000** |

## 26. Customer Deposits

See accounting policy in note 7.17.

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| With agreed maturity dates or periods of notice by remaining maturity: | | | |
| On demand | 397,194 | 334,136 | 182,500 |
| Not more than three months | 486,797 | 456,726 | 457,768 |
| More than three months but not more than one year | 1,171,481 | 1,076,046 | 688,446 |
| More than one year but not more than five years | 632,513 | 568,280 | 307,727 |
| | **2,687,985** | **2,435,188** | **1,636,441** |
| Fair value adjustments for portfolio hedging | (14,494) | (14,494) | (3,394) |
| **Customer deposits** | **2,673,491** | **2,420,694** | **1,633,047** |

## 27. Fair value of financial instruments

See accounting policy in note 7.12.

The following table analyses financial instruments that are both measured at fair value and not measured at fair value at the reporting date, by the level of fair value hierarchy into which the fair value measurement is categorised. The amounts are based on values recognised in the statement of financial position.

### Group

| At 31 December 2022 | Hierarchy level £000 | Amortised Cost £000 | Total carrying amount £000 | Fair Value £000 |
|---|---|---|---|---|
| Loan and Advances to Banks | Level 2 | 462,609 | 462,609 | 462,609 |
| Loans and Advances to Customers - FVTPL | Level 3 | - | 4,294 | 4,294 |
| Loans and Advances to Customers – at amortised cost | Level 3 | 2,650,063 | 2,650,063 | 2,726,978 |
| Investment Securities | Level 2 | 262,375 | 262,375 | 262,042 |
| Derivative Financial Instruments | Level 2 | - | 113,319 | 113,319 |
| Other Assets | Level 3 | 34,115 | 34,115 | 34,115 |
| **Total Financial Assets** | | **3,409,162** | **3,526,775** | **3,603,357** |
| Customer Deposits | Level 3 | 2,673,491 | 2,673,491 | 2,541,497 |
| Central Bank Facilities | Level 3 | 393,049 | 393,049 | 347,752 |
| Subordinated Liabilities | Level 2 | - | 30,337 | 30,337 |
| Derivative Financial Instruments | Level 2 | - | 19,136 | 19,136 |
| Finance Lease Liability | Level 3 | 923 | 923 | 923 |
| Other Liabilities | Level 3 | 145,608 | 145,608 | 145,608 |
| **Total Financial Liabilities** | | **3,213,071** | **3,262,544** | **3,085,253** |

### Bank

| At 31 December 2022 | Hierarchy level £000 | Amortised Cost £000 | Total carrying amount £000 | Fair Value £000 |
|---|---|---|---|---|
| Loan and Advances to Banks | Level 2 | 458,974 | 458,974 | 458,974 |
| Loans and Advances to Customers - FVTPL | Level 3 | - | 4,294 | 4,294 |
| Loans and Advances to Customers – at amortised cost | Level 3 | 2,243,123 | 2,243,123 | 2,333,058 |
| Investment Securities | Level 2 | 217,722 | 217,722 | 217,407 |
| Derivative Financial Instruments | Level 2 | - | 113,319 | 113,319 |
| Other Assets | Level 3 | 97,543 | 97,543 | 97,543 |
| **Total Financial Assets** | | **3,017,362** | **3,134,975** | **3,224,595** |
| Customer Deposits | Level 3 | 2,420,694 | 2,420,694 | 2,305,929 |
| Central Bank Facilities | Level 3 | 295,000 | 295,000 | 260,749 |
| Subordinated Liabilities | Level 2 | - | 30,336 | 30,336 |
| Derivative Financial Instruments | Level 2 | - | 19,136 | 19,136 |
| Finance Lease Liability | Level 3 | 647 | 647 | 647 |
| Other Liabilities | Level 3 | 175,433 | 175,433 | 175,433 |
| **Total Financial Liabilities** | | **2,891,774** | **2,941,246** | **2,792,230** |

| Group and Bank<br>At 31 December 2021 | Hierarchy level £000 | Amortised Cost £000 | Total carrying amount £000 | Fair Value £000 |
|---|---|---|---|---|
| Loan and Advances to Banks | Level 2 | 242,323 | 242,323 | 242,323 |
| Loans and Advances to Customers - FVTPL | Level 3 | - | 10,025 | 10,025 |
| Loans and Advances to Customers – at amortised cost | Level 3 | 1,704,683 | 1,704,683 | 1,830,504 |
| Investment Securities | Level 2 | 196,712 | 196,712 | 196,712 |
| Derivative Financial Instruments | Level 2 | - | 19,458 | 19,458 |
| Other Assets | Level 3 | 2,361 | 2,361 | 2,361 |
| **Total Financial Assets** | | **2,146,079** | **2,175,562** | **2,301,383** |
| Customer Deposits | Level 3 | 1,633,046 | 1,633,046 | 1,626,169 |
| Central Bank Facilities | Level 3 | 295,000 | 295,000 | 295,000 |
| Subordinated Liabilities | Level 2 | - | 30,202 | 31,151 |
| Derivative Financial Instruments | Level 2 | - | 4,413 | 4,413 |
| Finance Lease Liability | Level 3 | 1,895 | 1,895 | 1,895 |
| Other Liabilities | Level 3 | 36,929 | 36,929 | 36,929 |
| **Total Financial Liabilities** | | **1,966,870** | **2,001,485** | **1,995,557** |

### Level 3 fair value measurements

**i. Reconciliation**

The following table shows a reconciliation from the opening balances to the closing balances for fair value measurements in Level 3 of the fair value hierarchy:

### Loans and advances to customers

| Group and Bank | 2022 £'000 | 2021 £'000 |
|---|---|---|
| Balance at 1 January | **10,025** | **50,434** |
| Total gains or (losses): | | |
| *In profit or (loss)* | 473 | 1,251 |
| *Drawdowns on existing facilities* | 5,417 | 16,307 |
| *Repayments* | (11,621) | (57,967) |
| **Balance at 31 December** | **4,294** | **10,025** |

There were no transfers in or out of level 3.

**ii. Unobservable Inputs used in measuring fair value**

The only financial instruments where significant unobservable inputs have been used are loans and advances measured at FVTPL. These comprise certain property development loans within the Development Finance business line that do not meet the SPPI criteria.

The valuation technique used for these loans is discounted cash flow and the significant unobservable inputs are the risk-adjusted discount rate and the timing and amount of expected cash flows.

The range of estimates for the discount rate are approximate to the contractual interest margin on those loans. A significant increase or decrease in that margin would result in a lower or higher fair value. An average increase of 1% in the discount rate will result in a drop in fair value of £31k.

Significant unobservable inputs include timing and amount of expected cash flows from the sale of completed properties. These cash flows can fluctuate due to changes in construction schedules and consumer demand for the completed units and reasonably possible changes in those projected cash flows could result in a material impact on the fair value. Projected cash flows are derived from the business line's best estimates. An average delay of 5 months in sales will result in a £17k drop in fair value.

## 28. Allowance for credit impairment losses on financial assets at amortised cost

### i. IFRS 9

The following tables detail the gross carrying value of loans to customers by ECL stage.

As at 31 December 2022

| Group | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | POCI £'000 | Total £'000 |
|---|---|---|---|---|---|
| Development Finance | 169,310 | 46,334 | 8,995 | – | 224,639 |
| Specialist Mortgages | 1,371,692 | 301,491 | 37,084 | – | 1,710,267 |
| Asset Finance | 330,999 | 48,058 | 8,987 | 62 | 388,106 |
| Wholesale Finance | 152,001 | 14,212 | – | – | 166,213 |
| Commercial and Retail | 269,208 | 8,537 | 5,045 | 356 | 283,146 |
| **Total Exposure** | **2,293,210** | **418,632** | **60,111** | **418** | **2,772,371** |
| **Off Balance Sheet:** | | | | | |
| Loan Commitments | 393,178 | – | – | – | 393,178 |
| **Total Gross Exposure** | **2,686,388** | **418,632** | **60,111** | **418** | **3,165,549** |
| Less: FV losses from portfolio hedging | (79,903) | (21,289) | (70) | – | (101,262) |
| Less: allowance for impairment | (5,841) | (5,474) | (9,802) | 71 | (21,046) |
| **Total Net Exposure** | **2,600,644** | **391,869** | **50,239** | **489** | **3,043,241** |

As at 31 December 2022

| Bank | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|---|---|---|---|
| Development Finance | 169,310 | 46,334 | 8,995 | 224,639 |
| Specialist Mortgages | 1,371,692 | 301,491 | 37,084 | 1,710,267 |
| Asset Finance | 203,970 | 45,940 | 7,742 | 257,652 |
| Wholesale Finance | 152,001 | 14,212 | – | 166,213 |
| **Total Exposure** | **1,896,973** | **407,977** | **53,821** | **2,358,771** |
| **Off Balance Sheet:** | | | | |
| Loan Commitments | 393,178 | – | – | 393,178 |
| **Total Gross Exposure** | **2,290,151** | **407,977** | **53,821** | **2,751,949** |
| Less: FV losses from portfolio hedging | (79,903) | (21,289) | (70) | (101,262) |
| Less: allowance for impairment | (3,099) | (4,752) | (6,535) | (14,386) |
| **Total Net Exposure** | **2,207,149** | **381,936** | **47,216** | **2,636,301** |

### As at 31 December 2021

| Group and Bank | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|---|---|---|---|
| Development Finance | 127,228 | 11,010 | 10,511 | 148,749 |
| Specialist Mortgages | 1,190,531 | 104,689 | 19,130 | 1,314,350 |
| Asset Finance | 154,831 | 11,672 | 9,252 | 175,755 |
| Wholesale Finance | 93,213 | 419 | - | 93,632 |
| **Total Exposure** | **1,565,803** | **127,790** | **38,893** | **1,732,486** |
| **Off Balance Sheet:** | | | | |
| Loan Commitments | 311,012 | - | - | 311,012 |
| **Total Gross Exposure** | **1,876,815** | **127,790** | **38,893** | **2,043,498** |
| Less: FV losses from portfolio hedging | (15,751) | (872) | (8) | (16,631) |
| Less: allowance for impairment | (1,431) | (1,475) | (8,265) | (11,171) |
| **Total Net Exposure** | **1,859,633** | **125,443** | **30,620** | **2,015,696** |

Movements in the gross carrying amount of the Group's loans and advances to customers at amortised cost during the year that contributed to the changes in the associated loss allowance during the year are shown in the following tables. The tables are compiled by comparing the position at the end of the year to that at the beginning of the year. Transfers between stages are deemed to have taken place at the start of the year, with all other movements shown in the stage in which the asset is held at the end of the year.

## Gross Carrying Value — 2022

| Group<br>Development Finance | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **127,228** | **11,010** | **10,511** | **148,749** |
| Transfer to Stage 1 | 3,340 | (3,340) | - | - |
| Transfer to Stage 2 | (18,188) | 18,188 | - | - |
| Transfer to Stage 3 | - | (2,081) | 2,081 | - |
| Drawdowns/(Repayments) | 56,930 | 22,557 | (1,140) | 78,347 |
| Write offs | - | - | (2,457) | (2,457) |
| **Balance at 31 December** | **169,310** | **46,334** | **8,995** | **224,639** |

| Group<br>Specialist Mortgages | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **1,190,531** | **104,689** | **19,130** | **1,314,350** |
| Transfer to Stage 1 | 30,870 | (28,240) | (2,630) | - |
| Transfer to Stage 2 | (259,512) | 263,517 | (4,005) | - |
| Transfer to Stage 3 | (13,890) | (10,856) | 24,746 | - |
| Drawdowns/(Repayments) | 423,693 | (27,619) | 118 | 396,192 |
| Write offs | - | - | (275) | (275) |
| **Balance at 31 December** | **1,371,692** | **301,491** | **37,084** | **1,710,267** |

## Gross Carrying Value — 2022

| Group<br>Asset and Wholesale Finance | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | POCI<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|---|
| **Balance at 1 January** | **248,044** | **12,091** | **9,252** | **-** | **269,387** |
| **Acquired** | **192,253** | **-** | **-** | **343** | **192,596** |
| Transfer to Stage 1 | 3,641 | (2,451) | (1,190) | - | - |
| Transfer to Stage 2 | (27,489) | 29,088 | (1,599) | - | - |
| Transfer to Stage 3 | (6,102) | (514) | 6,616 | - | - |
| Drawdowns/(Repayments) | 72,653 | 24,056 | (2,199) | (690) | 93,820 |
| Write Offs | - | - | (1,893) | 409 | (1,484) |
| **Balance at 31 December** | **483,000** | **62,270** | **8,987** | **62** | **554,319** |

| Group<br>Commercial and Retail Finance | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | POCI<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|---|
| **Balance at 1 January** | **-** | **-** | **-** | **-** | **-** |
| **Acquired** | **301,380** | **-** | **-** | **924** | **302,304** |
| Transfer to Stage 1 | - | - | - | - | - |
| Transfer to Stage 2 | (9,209) | 9,209 | - | - | - |
| Transfer to Stage 3 | (5,211) | - | 5,211 | - | - |
| Drawdowns/(Repayments) | (17,752) | (672) | (141) | (543) | (19,108) |
| Write Offs | - | - | (25) | (25) | (50) |
| **Balance at 31 December** | **269,208** | **8,537** | **5,045** | **356** | **283,146** |

| Group<br>Total | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | POCI<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|---|
| **Balance at 1 January** | **1,565,803** | **127,790** | **38,893** | **-** | **1,732,486** |
| **Acquired** | **493,633** | **-** | **-** | **1,267** | **494,900** |
| Transfer to Stage 1 | 37,851 | (34,031) | (3,820) | - | - |
| Transfer to Stage 2 | (314,398) | 320,002 | (5,604) | - | - |
| Transfer to Stage 3 | (25,203) | (13,451) | 38,654 | - | - |
| Drawdowns/(Repayments) | 535,524 | 18,322 | (3,362) | (1,233) | 549,251 |
| Write Offs | - | - | (4,650) | 384 | (4,266) |
| **Balance at 31 December** | **2,293,210** | **418,632** | **60,111** | **418** | **2,772,371** |

## Gross Carrying Value — 2022

| Bank<br>Development Finance | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **127,228** | **11,010** | **10,511** | **148,749** |
| Transfer to Stage 1 | 3,340 | (3,340) | - | - |
| Transfer to Stage 2 | (18,188) | 18,188 | - | - |
| Transfer to Stage 3 | - | (2,081) | 2,081 | - |
| Drawdowns/(Repayments) | 56,930 | 22,557 | (1,140) | 78,347 |
| Write offs | - | - | (2,457) | (2,457) |
| **Balance at 31 December** | **169,310** | **46,334** | **8,995** | **224,639** |

| Bank<br>Specialist Mortgages | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **1,190,531** | **104,689** | **19,130** | **1,314,350** |
| Transfer to Stage 1 | 30,870 | (28,240) | (2,630) | - |
| Transfer to Stage 2 | (259,512) | 263,517 | (4,005) | - |
| Transfer to Stage 3 | (13,890) | (10,856) | 24,746 | - |
| Drawdowns/(Repayments) | 423,693 | (27,619) | 118 | 396,192 |
| Write offs | - | - | (275) | (275) |
| **Balance at 31 December** | **1,371,692** | **301,491** | **37,084** | **1,710,267** |

| Bank<br>Asset and Wholesale Finance | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **248,044** | **12,091** | **9,252** | **269,387** |
| Transfer to Stage 1 | 3,641 | (2,451) | (1,190) | - |
| Transfer to Stage 2 | (24,778) | 26,377 | (1,599) | - |
| Transfer to Stage 3 | (4,461) | (506) | 4,967 | - |
| Drawdowns/(Repayments) | 133,525 | 24,641 | (1,870) | 156,296 |
| Write Offs | - | - | (1,818) | (1,818) |
| **Balance at 31 December** | **355,971** | **60,152** | **7,742** | **423,865** |

| Bank<br>Total | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **1,565,803** | **127,790** | **38,893** | **1,732,486** |
| Transfer to Stage 1 | 37,851 | (34,031) | (3,820) | - |
| Transfer to Stage 2 | (302,478) | 308,082 | (5,604) | - |
| Transfer to Stage 3 | (18,351) | (13,443) | 31,794 | - |
| Drawdowns/(Repayments) | 614,148 | 19,579 | (2,892) | 630,835 |
| Write Offs | - | - | (4,550) | (4,550) |
| **Balance at 31 December** | **1,896,973** | **407,977** | **53,821** | **2,358,771** |

## Gross Carrying Value — 2021

| Group and Bank<br>Development Finance | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **92,632** | **16,243** | **7,757** | **116,632** |
| Transfer to Stage 1 | 4,138 | (4,138) | - | - |
| Transfer to Stage 2 | (3,179) | 3,179 | - | - |
| Transfer to Stage 3 | (3,334) | (610) | 3,944 | - |
| Drawdowns/(Repayments) | 36,971 | (3,664) | (1,190) | 32,117 |
| Write offs | - | - | - | - |
| **Balance at 31 December** | **127,228** | **11,010** | **10,511** | **148,749** |

| Group and Bank<br>Specialist Mortgages | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **818,061** | **72,342** | **5,345** | **895,748** |
| Transfer to Stage 1 | 43,607 | (43,359) | (248) | - |
| Transfer to Stage 2 | (105,012) | 105,311 | (299) | - |
| Transfer to Stage 3 | (5,897) | (6,034) | 11,931 | - |
| Drawdowns/(Repayments) | 439,772 | (23,571) | 2,441 | 418,642 |
| Write offs | - | - | (40) | (40) |
| **Balance at 31 December** | **1,190,531** | **104,689** | **19,130** | **1,314,350** |

| Group and Bank<br>Asset and Wholesale Finance | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **202,651** | **58,830** | **4,449** | **265,930** |
| Transfer to Stage 1 | 29,610 | (29,342) | (268) | - |
| Transfer to Stage 2 | (5,500) | 5,564 | (64) | - |
| Transfer to Stage 3 | (2,754) | (3,203) | 5,957 | - |
| Drawdowns/(Repayments) | 24,037 | (19,758) | 3,882 | 8,161 |
| Write Offs[1] | - | - | (4,704) | (4,704) |
| **Balance at 31 December** | **248,044** | **12,091** | **9,252** | **269,387** |

| Group and Bank<br>Total | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **1,113,343** | **147,416** | **17,551** | **1,278,310** |
| Transfer to Stage 1 | 77,355 | (76,839) | (516) | - |
| Transfer to Stage 2 | (113,691) | 114,054 | (363) | - |
| Transfer to Stage 3 | (11,985) | (9,847) | 21,832 | - |
| Drawdowns/(Repayments) | 500,780 | (46,993) | 5,133 | 458,920 |
| Write Offs[1] | - | - | (4,744) | (4,744) |
| **Balance at 31 December** | **1,565,803** | **127,790** | **38,893** | **1,732,486** |

1. This includes a single large write-off of £3.3m relating to a customer that became insolvent in November 2021.

## Loss allowance

| Group<br>Development Finance | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| | 2022 | | | |
| **Balance at 1 January** | **57** | **162** | **2,464** | **2,683** |
| Transfer to Stage 1 | 21 | (21) | - | - |
| Transfer to Stage 2 | (13) | 13 | - | - |
| Transfer to Stage 3 | (1) | (69) | 70 | - |
| **Net transfers** | **7** | **(77)** | **70** | **-** |
| Other changes in credit parameters & forward-looking information[1] | 90 | 2,073 | 558 | 2,721 |
| Additions and repayments[2] | 49 | (54) | (8) | (13) |
| **Charge to the Statement of Profit and Loss** | 139 | 2,019 | 550 | 2,708 |
| **Write offs/(Recoveries)** | - | - | (2,457) | (2,457) |
| **Balance at 31 December** | **203** | **2,104** | **627** | **2,934** |

| Group<br>Specialist Mortgages | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **639** | **838** | **1,356** | **2,833** |
| Transfer to Stage 1 | 553 | (407) | (146) | - |
| Transfer to Stage 2 | (100) | 524 | (424) | - |
| Transfer to Stage 3 | (7) | (123) | 130 | - |
| **Net transfers** | **446** | **(6)** | **(440)** | **-** |
| Other changes in credit parameters & forward-looking information[1] | (730) | 16 | 2,466 | 1,752 |
| Additions and repayments[2] | 1,327 | 1,210 | 468 | 3,005 |
| **Charge to the Statement of Profit and Loss** | 597 | 1,226 | 2,934 | 4,757 |
| **Write offs/(Recoveries)** | - | - | (275) | (275) |
| **Balance at 31 December** | **1,682** | **2,058** | **3,575** | **7,315** |

1. Changes in loss allowance as a result of movements due to changes in: credit risk parameters; adjustments to the models used for expected credit loss calculations; and, the forward-looking economic scenarios.
2. Expected loss allowances recognised on origination of new loans. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

## Loss allowance

| Group<br>Asset and Wholesale Finance | 2022<br>Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | POCI<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|---|
| **Balance at 1 January** | **735** | **475** | **4,445** | **-** | **5,655** |
| Acquired | 1,492 | - | - | - | 1,492 |
| Transfer to Stage 1 | 752 | (76) | (676) | - | - |
| Transfer to Stage 2 | (172) | 867 | (695) | - | - |
| Transfer to Stage 3 | (129) | (41) | 170 | - | - |
| **Net transfers** | **451** | **750** | **(1,201)** | **-** | **-** |
| Other changes in credit parameters & forward-looking information[1] | (824) | (359) | 1,042 | (240) | (381) |
| Additions and repayments[2] | 404 | (69) | 791 | (409) | 717 |
| **Charge to the Statement of Profit and Loss** | (420) | (428) | 1,833 | (649) | 336 |
| **Write offs/(Recoveries)** | - | - | (1,893) | 409 | (1,484) |
| **Balance at 31 December** | **2,258** | **797** | **3,184** | **(240)** | **5,999** |

| Group<br>Commercial and Retail Finance | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | POCI<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|---|
| **Balance at 1 January** | **-** | **-** | **-** | **-** | **-** |
| Acquired | 4,173 | - | - | - | 4,173 |
| Transfer to Stage 1 | - | - | - | - | - |
| Transfer to Stage 2 | (258) | 258 | - | - | - |
| Transfer to Stage 3 | (763) | - | 763 | - | - |
| **Net transfers** | **(1,021)** | **258** | **763** | **-** | **-** |
| Other changes in credit parameters & forward-looking information[1] | (1,397) | 249 | 1,816 | 169 | 837 |
| Additions and repayments[2] | (58) | 8 | (137) | 25 | (162) |
| **Charge to the Statement of Profit and Loss** | (1,455) | 257 | 1,679 | 194 | 675 |
| **Write offs/(Recoveries)** | - | - | (25) | (25) | (50) |
| **Balance at 31 December** | **1,697** | **515** | **2,417** | **169** | **4,798** |

1. Changes in loss allowance as a result of movements due to changes in: credit risk parameters; adjustments to the models used for expected credit loss calculations; and, the forward-looking economic scenarios.
2. Expected loss allowances recognised on origination of new loans. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

| **Group**<br>**Total** | **Stage 1**<br>**£'000** | **Stage 2**<br>**£'000** | **Stage 3**<br>**£'000** | **POCI**<br>**£'000** | **Total**<br>**£'000** |
|---|---|---|---|---|---|
| Balance at 1 January | 1,431 | 1,475 | 8,265 | – | 11,171 |
| Acquired | 5,665 | – | – | – | 5,665 |
| Transfer to Stage 1 | 1,326 | (504) | (822) | – | – |
| Transfer to Stage 2 | (543) | 1,662 | (1,119) | – | – |
| Transfer to Stage 3 | (900) | (233) | 1,133 | – | – |
| **Net transfers** | **(117)** | **925** | **(808)** | **-** | **-** |
| Other changes in credit parameters & forward-looking information[1] | (2,861) | 1,979 | 5,882 | (71) | 4,929 |
| Additions and repayments[2] | 1,722 | 1,095 | 1,114 | (384) | 3,547 |
| **Charge to the Statement of Profit and Loss** | (1,139) | 3,074 | 6,996 | (455) | 8,476 |
| **Write offs/(Recoveries)** | – | – | (4,650) | 384 | (4,266) |
| **Balance at 31 December** | **5,840** | **5,474** | **9,803** | **(71)** | **21,046** |

1. Changes in loss allowance as a result of movements due to changes in: credit risk parameters; adjustments to the models used for expected credit loss calculations; and, the forward-looking economic scenarios.
2. Expected loss allowances recognised on origination of new loans. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

## Loss allowance

| Bank<br>Development Finance | 2022<br>Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **57** | **162** | **2,464** | **2,683** |
| Transfer to Stage 1 | 21 | (21) | - | - |
| Transfer to Stage 2 | (13) | 13 | - | - |
| Transfer to Stage 3 | (1) | (69) | 70 | - |
| **Net transfers** | **7** | **(77)** | **70** | **-** |
| Other changes in credit parameters & forward-looking information[1] | 90 | 2,073 | 558 | 2,721 |
| Additions and repayments[2] | 49 | (54) | (8) | (13) |
| **Charge to the Statement of Profit and Loss** | 139 | 2,019 | 550 | 2,708 |
| **Write offs** | - | - | (2,457) | (2,457) |
| **Balance at 31 December** | **203** | **2,104** | **627** | **2,934** |

| Bank<br>Specialist Mortgages | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **639** | **838** | **1,356** | **2,833** |
| Transfer to Stage 1 | 553 | (407) | (146) | - |
| Transfer to Stage 2 | (100) | 524 | (424) | - |
| Transfer to Stage 3 | (7) | (123) | 130 | - |
| **Net transfers** | **446** | **(6)** | **(440)** | **-** |
| Other changes in credit parameters & forward-looking information[1] | (730) | 16 | 2,466 | 1,752 |
| Additions and repayments[2] | 1,327 | 1,210 | 468 | 3,005 |
| **Charge to the Statement of Profit and Loss** | 597 | 1,226 | 2,934 | 4,757 |
| **Write offs** | - | - | (275) | (275) |
| **Balance at 31 December** | **1,682** | **2,058** | **3,575** | **7,315** |

1. Changes in loss allowance as a result of movements due to changes in: credit risk parameters; adjustments to the models used for expected credit loss calculations; and, the forward-looking economic scenarios.
2. Expected loss allowances recognised on origination of new loans. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

## Loss allowance

| Bank<br>Asset and Wholesale Finance | 2022<br>Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **735** | **475** | **4,445** | **5,655** |
| Transfer to Stage 1 | 752 | (76) | (676) | - |
| Transfer to Stage 2 | (116) | 811 | (695) | - |
| Transfer to Stage 3 | (53) | (41) | 94 | - |
| **Net transfers** | 583 | 694 | (1,277) | - |
| Other changes in credit parameters & forward-looking information[1] | (606) | (510) | 259 | (857) |
| Additions and repayments[2] | 502 | (69) | 724 | 1,157 |
| **Charge to the Statement of Profit and Loss** | (104) | (579) | 983 | 300 |
| **Write offs** | - | - | (1,818) | (1,818) |
| **Balance at 31 December** | **1,214** | **590** | **2,333** | **4,137** |

| Bank<br>Total | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **1,431** | **1,475** | **8,265** | **11,171** |
| Transfer to Stage 1 | 1,326 | (504) | (822) | - |
| Transfer to Stage 2 | (229) | 1,348 | (1,119) | - |
| Transfer to Stage 3 | (61) | (233) | 294 | - |
| **Net transfers** | **1,036** | **611** | **(1,647)** | **-** |
| Other changes in credit parameters & forward-looking information[1] | (1,246) | 1,579 | 3,283 | 3,616 |
| Additions and repayments[2] | 1,878 | 1,087 | 1,184 | 4,149 |
| **Charge to the Statement of Profit and Loss** | 632 | 2,666 | 4,467 | 7,765 |
| **Write offs** | - | - | (4,550) | (4,550) |
| **Balance at 31 December** | **3,099** | **4,752** | **6,535** | **14,386** |

1. Changes in loss allowance as a result of movements due to changes in: credit risk parameters; adjustments to the models used for expected credit loss calculations; and, the forward-looking economic scenarios.
2. Expected loss allowances recognised on origination of new loans. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

## Loss allowance

| Group and Bank Development Finance | 2021 Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **321** | **632** | **2,317** | **3,270** |
| Transfer to Stage 1 | 23 | (23) | - | - |
| Transfer to Stage 2 | (24) | 24 | - | - |
| Transfer to Stage 3 | (11) | (263) | 274 | - |
| **Net transfers** | **(12)** | **(262)** | **274** | **-** |
| Other changes in credit parameters & forward-looking information[1] | (456) | 131 | (97) | (422) |
| Additions and repayments[2] | 204 | (339) | (30) | (165) |
| **Charge to the Statement of Profit and Loss** | (252) | (208) | (127) | (587) |
| **Write offs** | - | - | - | - |
| **Balance at 31 December** | **57** | **162** | **2,464** | **2,683** |

| Group and Bank Specialist Mortgages | Stage 1 £'000 | Stage 2 £'000 | Stage 3 £'000 | Total £'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **951** | **1,981** | **1,384** | **4,316** |
| Transfer to Stage 1 | 690 | (690) | - | - |
| Transfer to Stage 2 | (115) | 220 | (105) | - |
| Transfer to Stage 3 | (37) | (436) | 473 | - |
| **Net transfers** | 538 | (906) | 368 | - |
| Other changes in credit parameters & forward-looking information[1] | (1,392) | (465) | (386) | (2,243) |
| Additions and repayments[2] | 542 | 228 | 30 | 800 |
| **Charge to the Statement of Profit and Loss** | (850) | (237) | (356) | (1,443) |
| **Write offs** | - | - | (40) | (40) |
| **Balance at 31 December** | **639** | **838** | **1,356** | **2,833** |

1. Changes in loss allowance as a result of movements due to changes in: credit risk parameters; adjustments to the models used for expected credit loss calculations; and, the forward-looking economic scenarios.

2. Expected loss allowances recognised on origination of new loans. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.

## Loss allowance

| Group and Bank<br>Asset and Wholesale Finance | 2021<br>Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **789** | **4,311** | **2,691** | **7,791** |
| Transfer to Stage 1 | 1,858 | (1,786) | (72) | - |
| Transfer to Stage 2 | (30) | 59 | (29) | - |
| Transfer to Stage 3 | (42) | (350) | 392 | - |
| **Net transfers** | 1,786 | (2,077) | 291 | - |
| Other changes in credit parameters & forward-looking information[1] | (2,227) | (690) | 3,550 | 633 |
| Additions and repayments[2] | 387 | (1,069) | 2,617 | 1,935 |
| **Charge to the Statement of Profit and Loss** | (1,840) | (1,759) | 6,167 | 2,568 |
| **Write offs[3]** | - | - | (4,704) | (4,704) |
| **Balance at 31 December** | **735** | **475** | **4,445** | **5,655** |

| Group and Bank<br>Total | Stage 1<br>£'000 | Stage 2<br>£'000 | Stage 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Balance at 1 January** | **2,061** | **6,924** | **6,392** | **15,377** |
| Transfer to Stage 1 | 2,571 | (2,499) | (72) | - |
| Transfer to Stage 2 | (169) | 303 | (134) | - |
| Transfer to Stage 3 | (90) | (1,049) | 1,139 | - |
| **Net transfers** | 2,312 | (3,245) | 933 | - |
| Other changes in credit parameters & forward-looking information[1] | (4,075) | (1,024) | 3,067 | (2,032) |
| Additions and repayments[2] | 1,133 | (1,180) | 2,617 | 2,570 |
| **Charge to the Statement of Profit and Loss** | (2,942) | (2,204) | 5,684 | 538 |
| **Write offs[3]** | - | - | (4,744) | (4,744) |
| **Balance at 31 December** | **1,431** | **1,475** | **8,265** | **11,171** |

1. Changes in loss allowance as a result of movements due to changes in: credit risk parameters; adjustments to the models used for expected credit loss calculations; and, the forward-looking economic scenarios.
2. Expected loss allowances recognised on origination of new loans. Repayments relate to the reduction of loss allowances as a result of repayments of outstanding balances.
3. This includes a single large write-off of £3.3m relating to a customer that became insolvent in Novmber 2021.

Impairment losses on loans and advances to customers recognised in the Statement of Comprehensive Income for the Group and the Bank comprise of the following balances:

| | Group 2022 £000 | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|---|
| Increase/(Decrease) in ECL | 8,476 | 7,764 | 538 |
| Bad debt recoveries (Excluding POCI) | (457) | (456) | (1,128) |
| Impairments not reflected in ECL | 82 | - | - |
| Impairment (gains)/losses on loans and advances to customers | **8,101** | **7,308** | **(590)** |

### Post-Model Adjustments ("PMAs")

For year-end 2022, management determined that a series of PMAs totalling £1.4m (2021: £0.9m) are required across the Group's four key portfolios, which have been included in the respective loss allowance tables (page 108-110). PMAs are subject to formal provisioning governance and are approved by the Model Governance Committee. Each PMA is reviewed quarterly in line with the release of new macro-economic forecasts for continued applicability.

- ***Asset Finance:*** Due to the potential effects of the current period of elevated inflation, energy and other input prices, a PMA has been added to account for obligors in at-risk sectors (including sectors at risk from lower consumer spending). This has resulted in a PMA of £0.2m (2021: £0.5m). This PMA is expected to remain in place until either the economy has sufficiently recovered or inflation has normalised. A PMA has been applied to loans in this portfolio covered under the RLS (see note 7.21) reflecting the value of the guarantee provided by the British Business Bank and reduction in ECL of £0.1m (2021: nil)
- ***Acquisition Finance:*** Due to the potential effects of the current period of elevated interest rates, inflation, energy and other input prices, a PMA of £0.3m (2021: nil) has been added to account for obligors that may face a combination of rising costs and a decrease in consumer spending.
- ***Development Finance:*** A PMA of £0.1m (2021: £0.1m) has been determined based on the latest LGD model monitoring to compensate for the LGD model's under prediction versus experience on mid-construction defaults. The PMA will be reviewed quarterly as new data emerges. A PMA has been applied to loans in this portfolio covered under the RLS (see note 7.21) reflecting the value of the guarantee provided by the British Business Bank and reduction in ECL of £0.6m (2021: nil)
- ***Specialist Mortgages:*** The Bank undertook an exercise to understand the cladding / fire risk in its portfolio and management judgement has resulted in additional ECL allowance of £0.2m (2021: £0.3m). In addition, a further overlay of £1.3m (2021: nil) has been raised for exposures that are reaching the end of their fixed interest rate period during 2023 and face elevated refinance risk due to the current inflationary environment and the Bank of England's continued restrictive monetary policy, which has pushed up market interest rates. The PMA will be reviewed quarterly as new data emerges.

## 29.1. Financial Risk

This note presents information about the Group's exposure to financial risks and the Group's management of capital. The main areas of financial risk to which the Group is exposed are:

- Credit risk.
- Liquidity risk.
- Market risk.
- Capital risk.

## 29.2. Credit Risk

Credit risk is the risk of financial loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Credit risk appetite is set at Board level and is described and reported through a suite of metrics devised from a combination of accounting and credit portfolio performance measures, and includes the use of various credit risk rating systems to measure the credit risk of loans and advances to customers and banks at a counterparty level using three components: (i) the probability of default by the counterparty on its contractual obligations; (ii) the exposure to the counterparty at default; and (iii) the likely loss ratio on the defaulted obligations, the loss given default. The Group uses a range of approaches to mitigate credit risk, including policies, obtaining collateral, using master netting agreements. The Group's credit risk exposure, which arises solely in the United Kingdom, is set out below.

### i. Maximum credit exposure

The maximum credit risk exposure in the event of other parties failing to perform their obligations is presented below. No account is taken of any collateral held and the maximum exposure to loss is considered to be the balance sheet carrying amount or, for non-derivative off-balance sheet transactions, their contractual nominal amounts.

The maximum exposure to credit risk for financial assets is set out below:

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Loans and Advances to Banks & Investment Securities held at amortised cost | 724,984 | 676,696 | 439,035 |
| Loans and Advances to Customers at amortised cost | 2,772,371 | 2,358,771 | 1,732,486 |
| Loans and Advances to customers at FVTPL (not subject to impairment requirements) | 4,294 | 4,294 | 10,025 |
| Other assets: intercompany balances (note 33) | 63 | 73,653 | - |
| **Total on-balance sheet exposure** | **3,501,712** | **3,113,414** | **2,181,546** |
| Contractual loan commitments | 393,178 | 393,178 | 311,011 |
| **Maximum credit exposure** | **3,894,890** | **3,506,592** | **2,492,557** |

Contractual loan commitments represent agreements entered into but not advanced at 31 December 2022. However, undrawn loan facilities of £239.4m granted by Development Finance are legally drafted such that they can be drawn on demand but are uncommitted and can be withdrawn without notice.

## Quality of credit risk exposures

### Internal rating scales

In assessing the credit quality of the loan portfolio the Group uses an internal rating scale based on a customer's 12 month expected default probability.

| | Internal grading |
|---|---|
| Excellent quality | 1 |
| Good quality | 2 |
| Satisfactory quality | 3 |
| Lower quality | 4 |
| Below standard | 5 |

The following table sets out the current stage status of the loan portfolio compared with the internal rating at origination.

### Group

| Internal Rating at Origination | 12 month PD range | Stage 1 £000 | Stage 2 £000 | Stage 3 & POCI £000 | 2022 Total £000 |
|---|---|---|---|---|---|
| 1 | 0.0006-0.0045 | 298,691 | 81,718 | 3,490 | 383,899 |
| 2 | 0.0045-0.0105 | 739,735 | 132,158 | 22,554 | 894,447 |
| 3 | 0.0105-0.0240 | 926,754 | 146,278 | 27,405 | 1,100,437 |
| 4 | 0.0240-0.0550 | 286,048 | 47,303 | 3,626 | 336,977 |
| 5 | >0.0550 | 41,982 | 11,175 | 3,454 | 56,611 |
| | | **2,293,210** | **418,632** | **60,529** | **2,772,371** |

### Bank

| Internal Rating at Origination | 12 month PD range | Stage 1 £000 | Stage 2 £000 | Stage 3 & POCI £000 | 2022 Total £000 |
|---|---|---|---|---|---|
| 1 | 0.0006-0.0045 | 283,099 | 79,933 | 3,482 | 366,514 |
| 2 | 0.0045-0.0105 | 574,674 | 130,443 | 20,316 | 725,433 |
| 3 | 0.0105-0.0240 | 765,638 | 141,899 | 26,585 | 934,122 |
| 4 | 0.0240-0.0550 | 249,534 | 46,124 | 2,724 | 298,382 |
| 5 | >0.0550 | 24,028 | 9,578 | 714 | 34,320 |
| | | **1,896,973** | **407,977** | **53,821** | **2,358,771** |

### Bank

| Internal Rating at Origination | 12 month PD range | Stage 1 £000 | Stage 2 £000 | Stage 3 & POCI £000 | 2021 Total £000 |
|---|---|---|---|---|---|
| 1 | 0.0006-0.0045 | 138,350 | 18,436 | 1,090 | 157,876 |
| 2 | 0.0045-0.0105 | 526,499 | 58,219 | 12,927 | 597,645 |
| 3 | 0.0105-0.0240 | 640,241 | 39,336 | 22,882 | 702,459 |
| 4 | 0.0240-0.0550 | 237,881 | 10,315 | 1,716 | 249,912 |
| 5 | >0.0550 | 22,832 | 1,484 | 278 | 24,594 |
| | | **1,565,803** | **127,790** | **38,893** | **1,732,486** |

The following table sets out an analysis of stage 2 balances as at 31 December, reflecting the reason at that date for inclusion in stage 2.

| Group<br>As at 31 December 2022 | Gross carrying amount £000 | ECL £000 |
|---|---|---|
| Quantitative test – PD movement | 304,600 | 2,227 |
| Qualitative test – Forbearance and other support | 94,308 | 2,904 |
| 30 days past due back stop | 19,724 | 343 |
| | **418,632** | **5,474** |

| Bank<br>As at 31 December 2022 | Gross carrying amount £000 | ECL £000 |
|---|---|---|
| Quantitative test – PD movement | 301,829 | 2,134 |
| Qualitative test – Forbearance and other support | 86,424 | 2,275 |
| 30 days past due back stop | 19,724 | 343 |
| | **407,977** | **4,752** |

| Group and Bank<br>As at 31 December 2021 | Gross carrying amount £000 | ECL £000 |
|---|---|---|
| Quantitative test – PD movement | 65,208 | 866 |
| Qualitative test – Forbearance and other support | 62,467 | 597 |
| 30 days past due back stop | 115 | 12 |
| | **127,790** | **1,475** |

The following table sets out an analysis of the portion of stage 3 ECL, including POCI, in a cure period preceding transfer to stage 2 as at 31 December.

| Group<br>As at 31 December 2022 | Gross carrying amount £000 | ECL £000 |
|---|---|---|
| Credit-impaired not in cured period | 59,058 | 9,605 |
| No longer credit-impaired but in cured period that precedes transfer to stage 2 | 1,471 | 127 |
| | **60,529** | **9,732** |

| Bank<br>As at 31 December 2022 | Gross carrying amount £000 | ECL £000 |
|---|---|---|
| Credit-impaired not in cured period | 52,350 | 6,408 |
| No longer credit-impaired but in cured period that precedes transfer to stage 2 | 1,471 | 127 |
| | **53,821** | **6,535** |

| Group and Bank<br>As at 31 December 2021 | Gross carrying amount £000 | ECL £000 |
|---|---|---|
| Credit-impaired not in cured period | 36,901 | 7,412 |
| No longer credit-impaired but in cured period that precedes transfer to stage 2 | 1,992 | 853 |
| | **38,893** | **8,265** |

### Concentrations of credit risk

The Group monitors concentrations of credit risk by sector, size and by geographical location. An analysis of concentrations of credit risk from loans and advances, investment securities and contractual commitments is shown below.

## Group

| | Loans and advances to Banks & Investment Securities | | Loans and advances to Customers | | Contractual Commitments | |
|---|---|---|---|---|---|---|
| | 2022 £000 | 2021 £000 | 2022 £000 | 2021 £000 | 2022 £000 | 2021 £000 |
| Carrying amount | 724,984 | 439,035 | 2,650,063 | 1,704,683 | 393,178 | 311,011 |
| Concentration by sector: | | | | | | |
| Corporate | – | – | 2,196,072 | 1,335,020 | 374,222 | 270,719 |
| Government | 684,588 | 407,757 | – | – | | – |
| Banks | 40,396 | 31,278 | – | – | | – |
| Retail | – | – | 453,991 | 369,663 | 18,956 | 40,292 |
| | **724,984** | **439,035** | **2,650,063** | **1,704,683** | **393,178** | **311,011** |
| Concentration by location: | | | | | | |
| UK | 724,984 | 439,035 | 2,650,063 | 1,704,683 | 393,178 | 311,011 |

## Bank

| | Loans and advances to Banks & Investment Securities | | Loans and advances to Customers | | Contractual Commitments | |
|---|---|---|---|---|---|---|
| | 2022 £000 | 2021 £000 | 2022 £000 | 2021 £000 | 2022 £000 | 2021 £000 |
| Carrying amount | 676,696 | 439,035 | 2,243,123 | 1,704,683 | 393,178 | 311,011 |
| Concentration by sector: | | | | | | |
| Corporate | – | – | 1,796,399 | 1,335,020 | 374,222 | 270,719 |
| Government | 639,935 | 407,757 | – | – | | – |
| Banks | 36,761 | 31,278 | – | – | | – |
| Retail | | – | 446,724 | 369,663 | 18,956 | 40,292 |
| | **676,696** | **439,035** | **2,243,123** | **1,704,683** | **393,178** | **311,011** |
| Concentration by location: | | | | | | |
| UK | **676,696** | **439,035** | **2,243,123** | **1,704,683** | **393,178** | **311,011** |

### Collateral held and other credit enhancements

Collateral held by the Group includes land, residential and commercial property, and receivables, in the form of finance lease and hire purchase agreements. This collateral exceeds the carrying amount of loans and advances to customers at amortised cost and fair value.

The Group uses external agents to take physical possession of properties or other assets held as collateral and realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations.

In addition to the collateral included above, the Group also holds other types of collateral and credit enhancements such as personal guarantees, second charges and floating charges for which specific values are not generally available.

The carrying amount and the value of identifiable collateral (mainly residential property) held against loans and advances to corporate customers measured at amortised cost and categorised as stage 3, other than reverse sale and repurchase agreements was £77,234k (2021: £68,966k). For each loan, the value of disclosed collateral is capped at the nominal amount of the loan that it is held against.

An analysis by loan-to-value (LTV) ratio of the Bank's Specialist Mortgage lending is presented below. The value of collateral used in determining the LTV ratios has been estimated based upon the last actual valuation, adjusted to take into account subsequent movements in house prices.

## Group and Bank

### 31 December 2022

| LTV (Indexed) | Buy-to-let | Other lending | 2022 Total |
|---|---|---|---|
| Less than 60% | 419,653 | 169,611 | 589,264 |
| 60% to 65% | 250,461 | 131,436 | 381,897 |
| 65% to 70% | 237,336 | 130,489 | 367,825 |
| 70% to 75% | 172,751 | 113,989 | 286,740 |
| 75% to 80% | 35,969 | 42,167 | 78,136 |
| 80% to 85% | 239 | 1,663 | 1,902 |
| Over 85% | 1,706 | 2,797 | 4,503 |
| **Grand Total** | **1,118,115** | **592,152** | **1,710,267** |

## Bank

### 31 December 2021

| LTV (Indexed) | Buy-to-let | Other lending | 2021 Total |
|---|---|---|---|
| Less than 60% | 269,402 | 98,831 | 368,233 |
| 60% to 65% | 185,338 | 77,457 | 262,795 |
| 65% to 70% | 207,171 | 94,733 | 301,904 |
| 70% to 75% | 157,868 | 71,791 | 229,659 |
| 75% to 80% | 56,261 | 28,974 | 85,235 |
| 80% to 85% | 6,318 | 6,682 | 13,000 |
| Over 85% | 41,307 | 12,217 | 53,524 |
| **Grand Total** | **923,665** | **390,685** | **1,314,350** |

### Forbearance and loan modifications

The Group maintains a forbearance policy for the servicing and management of customers who are in financial difficulty and require some form of concession to be granted, even if this concession entails a loss for the Bank. The value of forborne loans for the Group and Bank respectively amounted £17.1m and £22.4m at 31 December 2022 (2021: £2.8m Group and Bank).

### Inputs, assumptions and techniques used for estimating impairment

The Group incorporates forward-looking information into both the assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and the measurement of ECL.

The Group employs five economic scenarios including a central scenario (“Base case”), and four less likely scenarios: one upside (“Upside 1”) and one downside scenario (“Downside 1”); and, one extreme upside (“Upside 2”) and one extreme downside (“Downside 2”) scenario. The central scenario is aligned with information used by the Group for other purposes such as strategic planning and budgeting. External information considered includes economic data from a leading independent economic forecasting consultant. A review is performed at least annually on the design of the scenarios.

The scenario probability weightings applied in measuring ECL are as follows:

| | Downside 2 | Downside 1 | Base | Upside 1 | Upside 2 |
|---|---|---|---|---|---|
| **As at 31 December 2022** | | | | | |
| Scenario probability weighting | 10% | 10% | 60% | 10% | 10% |
| **As at 31 December 2021** | | | | | |
| Scenario probability weighting | 10% | 10% | 60% | 10% | 10% |

The Group has identified and documented key drivers of credit risk and credit losses for each portfolio of financial instruments and has estimated relationships between macro-economic variables and credit risk and credit losses. The key drivers of credit risk identified are real GDP, unemployment rates, real estate prices (both residential and commercial), CPI inflation and interest rates (Bank of England Base Rate). The Bank estimates each key driver of credit risk over the active forecast period of 5 years.

The tables below lists the macroeconomic assumptions used in five scenarios over the 5-year forecast period. The assumptions represent the absolute percentage for interest rates and unemployment rates and average house prices.

### As at 31 December 2022

| Scenario | Economic variable | 2023 | 2024 | 2025 | 2026 | 2027 | Average 23-27 |
|---|---|---|---|---|---|---|---|
| **Upside 2** | HPI growth (%) | (2.8) | 0.3 | 6.2 | 5.5 | 5.4 | 2.9 |
| | Unemployment rate (%) | 3.5 | 2.8 | 2.3 | 2.2 | 2.2 | 2.6 |
| | CRE price growth (%) | 12.3 | 5.0 | 3.8 | 0.1 | 0.1 | 4.3 |
| | Bank of England rate | 5.5 | 5.4 | 4.0 | 2.6 | 2.5 | 4.0 |
| | CPI inflation (%) | 8.9 | 4.8 | 1.5 | 0.7 | 1.5 | 3.5 |
| | GDP Growth (%) | 3.0 | 3.8 | 3.9 | 2.5 | 1.5 | 3.0 |
| **Upside 1** | HPI growth (%) | (5.2) | (1.2) | 4.7 | 5.6 | 5.5 | 1.9 |
| | Unemployment rate (%) | 4.1 | 4.0 | 3.8 | 3.7 | 3.6 | 3.9 |
| | CRE price growth (%) | 7.6 | 4.4 | 3.7 | 0.9 | 0.8 | 3.5 |
| | Bank of England rate | 5.3 | 4.9 | 3.4 | 2.3 | 2.3 | 3.6 |
| | CPI inflation (%) | 8.3 | 3.9 | 1.4 | 0.7 | 1.4 | 3.1 |
| | GDP Growth (%) | 1.4 | 3.0 | 3.5 | 2.4 | 1.6 | 2.4 |
| **Base** | HPI growth (%) | (8.4) | (3.3) | 2.5 | 5.7 | 5.6 | 0.4 |
| | Unemployment rate (%) | 4.4 | 4.4 | 4.0 | 3.9 | 3.8 | 4.1 |
| | CRE price growth (%) | 0.6 | 2.9 | 3.1 | 2.4 | 2.0 | 2.2 |
| | Bank of England rate | 4.0 | 3.1 | 2.1 | 1.8 | 1.7 | 2.5 |
| | CPI inflation (%) | 7.6 | 2.5 | 1.2 | 0.8 | 1.5 | 2.7 |
| | GDP Growth (%) | (0.9) | 1.5 | 2.7 | 2.2 | 1.7 | 1.4 |
| **Downside 1** | HPI growth (%) | (14.6) | (7.9) | (2.8) | 6.1 | 6.0 | (2.6) |
| | Unemployment rate (%) | 5.3 | 6.5 | 7.1 | 6.9 | 6.6 | 6.5 |
| | CRE price growth (%) | (8.9) | 2.5 | 3.4 | 4.2 | 3.4 | 0.9 |
| | Bank of England rate | 3.5 | 2.9 | 1.9 | 1.3 | 1.3 | 2.2 |
| | CPI inflation (%) | 6.3 | 0.9 | 1.1 | 0.9 | 1.4 | 2.1 |
| | GDP Growth (%) | (4.6) | 0.2 | 2.3 | 2.1 | 1.8 | 0.4 |
| **Downside 2** | HPI growth (%) | (17.6) | (10.4) | (5.9) | 6.3 | 6.2 | (4.3) |
| | Unemployment rate (%) | 5.5 | 6.9 | 7.4 | 7.3 | 6.9 | 6.8 |
| | CRE price growth (%) | (13.9) | 1.9 | 3.3 | 5.3 | 4.3 | 0.2 |
| | Bank of England rate | 2.9 | 2.3 | 1.0 | 0.5 | 0.5 | 1.4 |
| | CPI inflation (%) | 5.7 | 0.1 | 1.0 | 1.0 | 1.4 | 1.8 |
| | GDP Growth (%) | (6.5) | (0.6) | 2.0 | 2.1 | 1.9 | (0.2) |

## As at 31 December 2021

| Scenario | Economic variable | 2022 | 2023 | 2024 | 2025 | 2026 | Average 22-26 |
|---|---|---|---|---|---|---|---|
| **Upside 2** | HPI growth (%) | 7.8 | 5.1 | 9.5 | 2.6 | 3.3 | 5.7 |
| | Unemployment rate (%) | 2.5 | 2.4 | 2.4 | 2.4 | 2.5 | 2.4 |
| | CRE price growth (%) | 12.1 | 1.9 | 0.6 | (1.2) | (0.8) | 2.5 |
| | Bank of England rate | 1.3 | 2.0 | 2.3 | 2.3 | 2.3 | 2.0 |
| | CPI inflation (%) | 5.5 | 3.2 | 2.1 | 1.6 | 2.2 | 2.9 |
| | GDP Growth (%) | 8.3 | 4.7 | 2.1 | 1.9 | 1.6 | 3.7 |
| **Upside 1** | HPI growth (%) | 4.3 | 2.6 | 6.9 | 2.7 | 3.5 | 4.0 |
| | Unemployment rate (%) | 3.4 | 3.5 | 3.6 | 3.6 | 3.6 | 3.6 |
| | CRE price growth (%) | 7.8 | 1.6 | 0.7 | (0.5) | (0.2) | 1.9 |
| | Bank of England rate | 0.9 | 1.8 | 2.0 | 2.0 | 2.0 | 1.7 |
| | CPI inflation (%) | 5.0 | 2.6 | 2.0 | 1.7 | 2.1 | 2.7 |
| | GDP Growth (%) | 6.9 | 4.1 | 1.9 | 1.8 | 1.7 | 3.3 |
| **Base** | HPI growth (%) | (0.5) | (0.6) | 1.5 | 3.0 | 3.7 | 1.4 |
| | Unemployment rate (%) | 4.2 | 4.0 | 3.8 | 3.7 | 3.7 | 3.9 |
| | CRE price growth (%) | 1.4 | 0.8 | 0.7 | 0.7 | 0.7 | 0.9 |
| | Bank of England rate | 0.5 | 0.7 | 1.0 | 1.2 | 1.5 | 1.0 |
| | CPI inflation (%) | 4.4 | 1.7 | 1.9 | 1.9 | 1.9 | 2.4 |
| | GDP Growth (%) | 4.9 | 2.8 | 1.6 | 1.8 | 1.7 | 2.6 |
| **Downside 1** | HPI growth (%) | (9.4) | (9.1) | (5.4) | 3.6 | 4.3 | (3.2) |
| | Unemployment rate (%) | 5.6 | 6.1 | 6.3 | 6.2 | 6.0 | 6.0 |
| | CRE price growth (%) | (7.7) | 0.5 | 0.9 | 2.4 | 2.0 | (0.4) |
| | Bank of England rate | 0.0 | 0.3 | 0.3 | 0.5 | 0.5 | 0.3 |
| | CPI inflation (%) | 3.3 | 0.6 | 1.7 | 2.0 | 1.6 | 1.8 |
| | GDP Growth (%) | 1.0 | 2.0 | 1.2 | 1.7 | 1.8 | 1.6 |
| **Downside 2** | HPI growth (%) | (13.9) | (13.9) | (10.7) | 4.0 | 4.8 | (5.9) |
| | Unemployment rate (%) | 6.1 | 6.5 | 6.6 | 6.4 | 6.3 | 6.4 |
| | CRE price growth (%) | (12.4) | 0.1 | 0.9 | 3.4 | 2.9 | (1.0) |
| | Bank of England rate | (0.3) | (0.3) | 0.0 | 0.0 | 0.0 | (0.1) |
| | CPI inflation (%) | 2.7 | 0.1 | 1.7 | 2.1 | 1.5 | 1.6 |
| | GDP Growth (%) | (0.9) | 1.4 | 0.9 | 1.7 | 1.9 | 1.0 |

The base scenario is a recommended base case from Oxford Economics in which risks to the overall outlook remain skewed to the downside and the range of possible outcomes is wider than under normal times due to on-going economic uncertainty. Based on the December 2022 forecast, the UK economy is expected to shrink by 0.9% in 2023 before rebounding by 1.5% in 2024 and 2.7% in 2025.

As a result of the increase in inflation, by raising interest rates, the BoE is signalling a clear need to reinforce its inflation-fighting mandate.

### Sensitivity of ECL to future economic conditions

The ECL is sensitive to judgements and assumptions made regarding formulation of forward-looking scenarios and how such scenarios are incorporated into the calculations. Management performs a sensitivity analysis on the ECL recognised on the Bank's material asset classes.

The table below shows the model of loss allowance on loans and advances to customers assuming each forward-looking scenario (e.g. base, upside and downside) were weighted 100% instead of applying scenario probability weights across the five scenarios.

### Group

| As at 31 December 2022 | Downside 2 | Downside 1 | Base | Upside 1 | Upside 2 |
|---|---|---|---|---|---|
| Gross exposure (£'000) | 2,772,371 | 2,772,371 | 2,772,371 | 2,772,371 | 2,772,371 |
| Loss allowance (£'000) | 31,676 | 28,363 | 22,560 | 21,055 | 19,797 |
| Loss allowance stage 2 (£'000) | 11,060 | 8,782 | 4,645 | 3,441 | 2,500 |
| Proportion of loss allowance in Stage 2 | 34.92% | 30.96% | 20.59% | 16.34% | 12.63% |

### Bank

| As at 31 December 2022 | Downside 2 | Downside 1 | Base | Upside 1 | Upside 2 |
|---|---|---|---|---|---|
| Gross exposure (£'000) | 2,358,771 | 2,358,771 | 2,358,771 | 2,358,771 | 2,358,771 |
| Loss allowance (£'000) | 21,831 | 18,664 | 13,313 | 11,928 | 10,834 |
| Loss allowance stage 2 (£'000) | 10,347 | 8,095 | 4,040 | 2,864 | 1,967 |
| Proportion of loss allowance in Stage 2 | 47.39% | 43.37% | 30.35% | 24.01% | 18.16% |

### Group and Bank

| As at 31 December 2021 | Downside 2 | Downside 1 | Base | Upside 1 | Upside 2 |
|---|---|---|---|---|---|
| Gross exposure (£'000) | 1,732,486 | 1,732,486 | 1,732,486 | 1,732,486 | 1,732,486 |
| Loss allowance (£'000) | 14,731 | 12,639 | 10,655 | 10,305 | 10,109 |
| Loss allowance stage 2 (£'000) | 3,469 | 2,258 | 1,168 | 1,049 | 984 |
| Proportion of loss allowance in Stage 2 | 23.55% | 17.87% | 10.96% | 10.12% | 9.73% |

### 29.3. Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due or cannot do so without incurring unacceptable losses. The Group measures liquidity risk on a daily basis to ensure it has adequate liquidity to meet both internal risk appetite and regulatory requirements. Daily liquidity reporting is supplemented by a range of early warning indicators to help identify signs of liquidity risk. The Group regularly stress tests its liquidity requirements against a number of scenarios, these scenarios and underlying assumptions are reviewed at least annually to ensure they continue to be relevant. As part of the Recovery Plan the Group maintains a Liquidity Contingency Plan which contains mitigating actions available during a stress. Monthly reporting procedures are in place to update and inform senior management and all liquidity policies and procedures are subject to periodic independent internal oversight.

During 2021 the Group repaid all outstanding Bank of England (BoE) Term Funding Scheme (TFS) drawings and drew £295m under the Term Funding Scheme with Additional Incentives for SMEs (TFSME) before the scheme closure in October 2021. The Bank continues to maintain contingent liquidity in the form of drawing capacity against eligible assets with the BoE.

The table below analyses remaining contractual maturity undiscounted cash flows of non-derivative financial assets and liabilities.

## Group

| At 31 December 2022 | Carrying value £000 | Net inflow /(outflow) £000 | Up to 1 month £000 | 1 to 3 months £000 | 3 to 12 months £000 | 1 to 5 years £000 | Over 5 Years £000 |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Loan and advances to Banks | 462,609 | 462,609 | 462,609 | - | - | - | - |
| Loans and advances to customers | 2,654,358 | 3,739,160 | 83,415 | 84,769 | 307,524 | 720,232 | 2,543,220 |
| Investment Securities | 262,376 | 266,756 | 10,042 | 190,762 | 40,529 | 25,423 | - |
| Contractual loan commitments | 393,178 | 393,178 | 138,281 | 17,147 | 108,068 | 129,682 | - |
| **Total** | **3,772,521** | **4,861,703** | **694,347** | **292,678** | **456,121** | **875,337** | **2,543,220** |
| **Liabilities** | | | | | | | |
| Deposits | (2,672,491) | (2,736,041) | (561,098) | (322,882) | (1,184,167) | (667,894) | - |
| Central Bank Facilities | (393,049) | (434,016) | (3,525) | - | (10,493) | (419,998) | - |
| Contractual loan commitments | (393,178) | (393,178) | (138,281) | (17,147) | (108,068) | (129,682) | - |
| Subordinated Debt | (30,000) | (31,088) | - | - | (31,088) | - | - |
| Capital Securities | (17,030) | (27,526) | - | - | (1,504) | (26,022) | - |
| **Total** | **(3,505,748)** | **(3,621,849)** | **(702,904)** | **(340,029)** | **(1,335,320)** | **(1,243,596)** | **-** |

## Bank

| At 31 December 2022 | Carrying value £000 | Net inflow /(outflow) £000 | Up to 1 month £000 | 1 to 3 months £000 | 3 to 12 months £000 | 1 to 5 years £000 | Over 5 Years £000 |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Loan and advances to Banks | 458,974 | 458,974 | 458,974 | - | - | - | - |
| Loans and advances to customers | 2,247,417 | 3,168,473 | 72,540 | 66,857 | 241,207 | 504,907 | 2,282,962 |
| Investment Securities | 217,722 | 221,756 | 42 | 180,762 | 15,529 | 25,423 | - |
| Contractual loan commitments | 393,178 | 393,178 | 138,281 | 17,147 | 108,068 | 129,682 | - |
| **Total** | **3,317,291** | **4,242,381** | **669,837** | **264,766** | **364,804** | **660,012** | **2,282,962** |
| **Liabilities** | | | | | | | |
| Deposits | (2,420,694) | (2,468,694) | (489,239) | (301,602) | (1,084,254) | (593,599) | - |
| Central Bank Facilities | (295,000) | (326,282) | (2,602) | - | (7,723) | (315,957) | - |
| Contractual loan commitments | (393,178) | (393,177) | (138,280) | (17,147) | (108,068) | (129,682) | - |
| Subordinated Debt | (30,000) | (31,088) | - | - | (31,088) | - | - |
| Capital Securities | (17,030) | (27,526) | - | - | (1,504) | (26,022) | - |
| **Total** | **(3,155,902)** | **(3,246,767)** | **(630,121)** | **(318,749)** | **(1,232,637)** | **(1,065,260)** | **-** |

### Group and Bank

| At 31 December 2021 | Carrying value £000 | Net inflow /(outflow) £000 | Up to 1 month £000 | 1 to 3 months £000 | 3 to 12 months £000 | 1 to 5 years £000 | Over 5 Years £000 |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Loan and advances to Banks | 242,323 | 242,323 | 242,323 | - | - | - | - |
| Loans and advances to customers | 1,714,708 | 2,457,598 | 15,353 | 36,976 | 175,888 | 482,284 | 1,747,097 |
| Investment Securities | 196,712 | 201,945 | 51 | 127,857 | 57,843 | 16,194 | - |
| Contractual loan commitments | 311,012 | 311,012 | 93,517 | 44,743 | 124,554 | 48,198 | - |
| **Total** | **2,464,755** | **3,212,878** | **351,244** | **209,576** | **358,285** | **546,676** | **1,747,097** |
| **Liabilities** | | | | | | | |
| Deposits | (1,633,046) | (1,643,004) | (367,095) | (270,071) | (691,433) | (314,405) | - |
| Central Bank Facilities | (295,000) | (297,865) | (85) | - | (546) | (297,234) | - |
| Contractual loan commitments | (311,012) | (311,012) | (93,517) | (44,743) | (124,554) | (48,198) | - |
| Subordinated Debt | (30,000) | (33,263) | - | - | (2,175) | (31,088) | - |
| **Total** | **(2,269,058)** | **(2,285,144)** | **(460,697)** | **(314,814)** | **(818,708)** | **(690,925)** | **-** |

### Liquidity Reserves

The Group has a strong liquidity position and holds high quality liquid assets comprising cash placed on deposit with the Bank of England, Debt Securities issued by Sovereigns and UK Covered Bonds which can be quickly monetised through repurchase agreements or outright sale.

The following table details the components of the Group's liquidity reserves as at 31 December:

| | Group | | Bank | | Group and Bank | |
|---|---|---|---|---|---|---|
| | 2022 Carrying value £000 | 2022 Fair Value £000 | 2022 Carrying value £000 | 2022 Fair Value £000 | 2021 Carrying value £000 | 2021 Fair Value £000 |
| Cash and balances at central banks | 452,098 | 452,098 | 452,098 | 452,098 | 229,949 | 229,949 |
| Unencumbered debt securities issued by sovereigns | 95,480 | 95,480 | 85,100 | 85,100 | 1,543 | 1,543 |
| Unencumbered Covered Bonds | 33,462 | 33,462 | 33,462 | 33,462 | 20,042 | 20,042 |
| **Total liquidity reserves** | **581,040** | **581,040** | **570,660** | **570,660** | **251,534** | **251,534** |

### Financial assets pledged as collateral

Financial assets recognised in the statement of financial position that had been pledged as collateral for liabilities at 31 December 2022 are £433.2m for Group and £321.7m for Bank (2021: £378.7m).

Financial assets are pledged as collateral as part of sales and repurchases under terms that are usual and customary for such activities.

### Offsetting financial assets and financial liabilities

The Group's derivative transactions are entered into under International Swaps and Derivatives Association (ISDA) master netting agreements. The Group executes a credit support annex in conjunction with the ISDA agreement, which requires the Group and its counterparties to post collateral to mitigate counterparty credit risk and gives the right to each party to terminate the related transactions on the failure to post collateral. The following table outlines financial assets and liabilities subject to enforceable master netting arrangements as at 31 December.

## Group

| | | Related amounts not offset in the statement of financial position | | |
|---|---|---|---|---|
| As at 31 December 2022 | Assets/(Liabilities) recognised in the statement of financial position £000 | Financial instruments (including non-cash collateral) £000 | Cash collateral (received)/ pledged £000 | Net amount £000 |
| Derivative assets held for risk management | 112,889 | (18,931) | (88,980) | 4,978 |
| Derivative liabilities held for risk management | (18,931) | 18,931 | - | - |
| **Total** | **93,958** | **-** | **(88,980)** | **4,978** |

## Bank

| | | Related amounts not offset in the statement of financial position | | |
|---|---|---|---|---|
| As at 31 December 2022 | Assets/(Liabilities) recognised in the statement of financial position £000 | Financial instruments (including non-cash collateral) £000 | Cash collateral (received)/ pledged £000 | Net amount £000 |
| Derivative assets held for risk management | 112,889 | (18,931) | (88,980) | 4,978 |
| Derivative liabilities held for risk management | (18,931) | 18,931 | - | - |
| **Total** | **93,958** | **-** | **(88,980)** | **4,978** |

## Group and Bank

| | | Related amounts not offset in the statement of financial position | | |
|---|---|---|---|---|
| As at 31 December 2021 | Assets/(Liabilities) recognised in the statement of financial position £000 | Financial instruments (including non-cash collateral) £000 | Cash collateral (received)/ pledged £000 | Net amount £000 |
| Derivative assets held for risk management | 19,458 | (3,899) | (15,559) | - |
| Derivative liabilities held for risk management | (4,413) | 3,899 | - | (514) |
| **Total Liabilities** | **15,045** | **-** | **(15,559)** | **(514)** |

There are no asset and liability balances which are offset within the statement of financial position.

### 29.4. Market risk

Market risk is the risk that changes in market prices will affect the Group's income or the value of its holdings of financial instruments. The Bank does not engage in any trading operations. The Group's exposure to foreign currency risk is limited and managed by ALCO on a monthly basis.

#### A. Interest rate risk

Interest rate risk is the potential adverse impact on the Group's future cash flows from changes in interest rates and arises from the differing interest rate risk characteristics of the Group's assets and liabilities. In particular, fixed rate products expose the Group to the risk that a change in interest rates could cause either a reduction in interest income or an increase in interest expense relative to variable rate interest flows.

The Group manages and controls interest rate risk through its hedging strategy. Interest rate exposure is managed by ALCO on a monthly basis, and it operates within pre-agreed limits.

ALCO's activities include monitoring changes in the Bank's interest rate exposures, which include the impact of the Group's outstanding or forecast debt obligations and changes to exposures arising from IBOR reform. ALCO is responsible for setting the overall hedging strategy of the Group. Central Treasury is responsible for implementing that strategy by putting in place the individual hedge arrangements. Many of those hedge arrangements are designated in hedging relationships for accounting purposes (see note 21).

#### B. Interest rate sensitivity gap

The Group considers a parallel 200 basis points movement to be appropriate for scenario testing given the current economic outlook and industry expectations. The change in equity as a result, based on the present value of future cash flows discounted using Sterling Overnight Index Average ("SONIA"), would be as follows:

| | 2022<br>£000 | 2021<br>£000 |
|---|---|---|
| +200 basis points | (7,327) | (1,447) |
| -200 basis points | 7,973 | 1,738 |

The table below provides an analysis of the re-pricing periods of assets and liabilities. Mismatches in the re-pricing timing of assets and liabilities creates interest rate risk. Items are allocated to time bands by reference to the earlier of the next contractual interest rate re-pricing date and the residual maturity date.

| Group<br>At 31 December 2022 | Up to 1 month £000 | 1 to 3 months £000 | 3 to 12 months £000 | 1 to 7 years £000 | Non-interest bearing £000 | Total £000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Loan and advances to Banks | 462,609 | - | - | - | - | 462,609 |
| Loans and advances to customers | 1,771,871 | 246,869 | 348,714 | 410,394 | - | 2,777,848 |
| Investment Securities | 43,453 | 184,409 | 34,513 | - | - | 262,375 |
| Other assets | - | - | - | - | 43,000 | 43,000 |
| Total Assets | 2,277,933 | 431,278 | 383,227 | 410,394 | 43,000 | 3,545,832 |
| **Liabilities and Equity** | | | | | | |
| Customer Deposits | 525,399 | 360,260 | 1,157,392 | 630,440 | - | 2,673,491 |
| Central Bank Facilities | 393,049 | - | - | - | - | 393,049 |
| Subordinated Liabilities | - | - | 30,337 | - | - | 30,337 |
| Non-interest bearing liabilities | 88,980 | - | - | - | 77,058 | 166,038 |
| Equity | - | - | - | 17,030 | 265,887 | 282,917 |
| Total Liabilities | 1,007,428 | 360,260 | 1,187,729 | 647,470 | 342,945 | 3,545,832 |
| Interest rate sensitivity gap | 1,270,505 | 71,018 | (804,502) | (237,076) | (299,945) | |
| Cumulative gap | 1,270,505 | 1,341,523 | 537,021 | 299,945 | - | |
| Notional value of derivatives | 46,900 | 309,200 | 720,900 | (1,077,000) | - | |

| Bank<br>At 31 December 2022 | Up to 1 month £000 | 1 to 3 months £000 | 3 to 12 months £000 | 1 to 7 years £000 | Non-interest bearing £000 | Total £000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Loan and advances to Banks | 458,974 | - | - | - | - | 458,974 |
| Loans and advances to customers | 1,464,929 | 234,858 | 279,589 | 383,690 | - | 2,363,066 |
| Investment Securities | 33,462 | 174,452 | 9,808 | - | - | 217,722 |
| Other assets | - | - | - | - | 160,721 | 160,721 |
| Total Assets | 1,957,365 | 409,310 | 289,397 | 383,690 | 160,721 | 3,200,483 |
| **Liabilities and Equity** | | | | | | |
| Customer Deposits | 431,553 | 360,260 | 1,062,411 | 566,470 | - | 2,420,694 |
| Central Bank Facilities | 295,000 | - | - | - | - | 295,000 |
| Subordinated Liabilities | - | - | 30,337 | - | - | 30,337 |
| Non-interest bearing liabilities | 88,980 | - | - | - | 106,608 | 195,588 |
| Equity | - | - | - | 17,030 | 241,834 | 258,864 |
| Total Liabilities | 815,533 | 360,260 | 1,092,748 | 583,500 | 348,442 | 3,200,483 |
| Interest rate sensitivity gap | 1,141,832 | 49,050 | (803,351) | (199,810) | (187,721) | - |
| Cumulative gap | 1,141,832 | 1,190,882 | 387,531 | 187,721 | - | - |
| Notional value of derivatives | 49,900 | 309,200 | 720,900 | (1,077,000) | - | - |

| Group and Bank<br>At 31 December 2021 | Up to 1 month £000 | 1 to 3 months £000 | 3 to 12 months £000 | 1 to 7 years £000 | Non-interest bearing £000 | Total £000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Loan and advances to Banks | 242,323 | - | - | - | - | 242,323 |
| Loans and advances to customers | 250,306 | 29,480 | 132,816 | 1,302,106 | - | 1,714,708 |
| Investment Securities | 146,601 | - | 50,111 | - | - | 196,712 |
| Other assets | - | - | - | - | 36,788 | 36,788 |
| Total Assets | 639,230 | 29,480 | 182,927 | 1,302,106 | 36,788 | 2,190,531 |
| **Liabilities and Equity** | | | | | | |
| Customer Deposits | 273,567 | 181,638 | 825,366 | 352,475 | - | 1,633,046 |
| Central Bank Facilities | 295,000 | - | - | - | - | 295,000 |
| Subordinated Liabilities | - | - | - | 30,202 | - | 30,202 |
| Non-interest bearing liabilities | - | - | - | - | 43,447 | 43,447 |
| Equity | - | - | - | - | 188,836 | 188,836 |
| Total Liabilities | 568,567 | 181,638 | 825,366 | 382,677 | 232,283 | 2,190,531 |
| Interest rate sensitivity gap | 70,663 | (152,158) | (642,439) | 919,429 | (195,495) | - |
| Cumulative gap | 70,663 | (81,495) | (723,934) | 195,495 | - | - |
| Notional value of derivatives | 405,300 | 49,100 | 436,200 | (890,600) | - | - |

## C. Managing interest rate benchmark reform and associated risks

### IBOR Transition

A fundamental reform of major interest rate benchmarks is being undertaken globally including the replacement of some interbank offered rates (IBORs) with alternative risk free rates. This work is known as 'IBOR Reform'. The Group had exposure to IBORs in the form of LIBOR-referencing fixed/floating interest rate swaps during 2021 that were reformed as part of these market wide initiatives. The Group ceased writing any new interest rate derivatives referencing IBORs during 2020 and replaced all existing LIBOR swaps with SONIA referencing swaps during Q3 2021. Although the Group ceased writing new LIBOR-referencing loans in Q4 2020, the Group has a back-book of LIBOR-referencing or LIBOR-linked loans. We are currently working to migrate as many loans as possible to Base rate during 2023

The primary risk that the Group has been exposed to in respect of these IBOR reforms are operational including renegotiation of loan contracts, updating contractual terms and updating systems which utilise IBOR curves. Financial risk is limited to interest rate risk.

During 2021 and 2022, the Group had the following principal IBOR exposures in respect of derivative financial assets and loan commitments subject to the reform

- Floating rate loans and advances to customers, GBP LIBOR.
- Loan commitments indexed to GBP LIBOR

### Derivatives

The Group holds interest rate swaps for risk management purposes which are designated in cash flow hedging relationships. The interest rate swaps have floating legs that as at 31 December 2022 are indexed to SONIA. The Group's derivative instruments are governed by contracts based on the International Swaps and Derivatives Association (ISDA) master agreements.

ISDA has reviewed its standardised contracts in light of IBOR reform and has published an IBOR fall-back supplement to amend the 2006 ISDA definitions. The Group has adhered to this protocol.

The following table shows the total amount of unreformed financial assets and loan commitments as at 31 December 2021 and 31 December 2022. The amount of trading assets are shown at their carrying amounts and the amounts of loans and advances to customers are shown at their gross carrying amounts The amounts of loan commitments are shown at their committed amounts.

| Loans and advances to customers | 31 December 2022 £000 | 31 December 2021 £000 |
|---|---|---|
| Specialist Mortgages | 349,221 | 504,688 |
| Development finance | 10,166 | 26,541 |
| | **359,387** | **531,229** |
| Loan commitments | 35 | 9,343 |
| | **359,422** | **540,572** |

## 30. Property Plant and Equipment

See accounting policy in note 7.15.

| Group | Office Equipment £000 | Fixtures and fittings £000 | Equipment for hire £000 | Leasehold improvements £000 | Total £000 |
|---|---|---|---|---|---|
| ***Cost*** | | | | | |
| At 1 January 2022 | **2,070** | **2,446** | **-** | **-** | **4,516** |
| Acquired as part of business combination | 187 | 188 | 6,101 | 72 | 6,548 |
| Additions | 554 | 3 | 799 | - | 1,356 |
| Disposals | (118) | - | (1,486) | (72) | (1,676) |
| At 31 December 2022 | **2,693** | **2,637** | **5,414** | **-** | **10,744** |
| ***Depreciation*** | | | | | |
| At 1 January 2022 | **1,584** | **1,461** | **-** | | **3,045** |
| Acquired as part of business combination | 80 | 181 | 2,638 | 10 | 2,909 |
| Charge for year | 350 | 268 | 1,469 | 62 | 2,149 |
| Depreciation release on disposal | (71) | - | (1,295) | (72) | (1,438) |
| At 31 December 2022 | **1,943** | **1,910** | **2,812** | **-** | **6,665** |
| ***Net book value*** | | | | | |
| At 31 December 2022 | **750** | **727** | **2,602** | **-** | **4,079** |
| At 31 December 2021 | **486** | **985** | **-** | **-** | **1,471** |

| Bank | Office Equipment £000 | Fixtures and fittings £000 | Total £000 |
|---|---|---|---|
| ***Cost*** | | | |
| At 1 January 2022 | **2,070** | **2,446** | **4,516** |
| Additions | 540 | 3 | 543 |
| At 31 December 2022 | **2,610** | **2,449** | **5,059** |
| ***Depreciation*** | | | |
| At 1 January 2022 | **1,584** | **1,461** | **3,045** |
| Charge for year | 309 | 262 | 571 |
| At 31 December 2022 | **1,893** | **1,723** | **3,616** |
| ***Net book value*** | | | |
| At 31 December 2022 | **717** | **726** | **1,443** |
| At 31 December 2021 | **486** | **985** | **1,471** |

There were no capitalised borrowing costs related to the acquisition of Property, Plant and Equipment during the year (2021: nil).

No impairment charges were incurred during the year (2021: nil).

The net book value of equipment for hire represents the value of equipment leased to customers on operating leases. These agreements do not give the customer rights and benefits equivalent to ownership of the asset and the expectation is that the equipment subject to these agreements will be returned to the Bank at the end of the lease period.

The future minimum lease payments under non-cancellable operating leases are repayable as follows:

| Group and Bank<br>Gross investment in operating lease receivables: | 2022 £'000 |
|---|---|
| Year 1 | 1,088 |
| Year 2 | 536 |
| Year 3 | 111 |
| Total future repayments | 1,735 |
| Unearned finance income | (273) |
| Net investment | 1,462 |

Rentals receivable during the year under operating leases amounted to £1,983k. In the year to 31 December 2022 the Bank recognised £37k of contingent rentals as income.

## 31. Finance leases

See accounting policy in note 7.6.

The Group leases office premises and these are presented as Right-of-Use assets on a separate line in the statement of financial position. The Net book value and accumulated depreciation charge on right of use assets as at 31 December 2022 is as follows:

| Right of use asset – Office premise | Group 2022 £000 | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|---|
| Net book value at 1 January | 1,608 | 1,608 | 2,535 |
| Acquired as part of business combination | 382 | - | - |
| Net book value at 31 December | 762 | 685 | 1,608 |
| Depreciation at 31 December | 5,927 | 5,695 | 4,773 |

The lease liabilities are secured by the related underlying assets. The undiscounted maturity analysis of lease liabilities at 31 December 2021 is as follows:

| | Group 2022 £000 | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|---|
| Year 1 | 810 | 673 | 1,318 |
| Year 2 | 86 | - | 660 |
| Year 3 | 53 | - | - |
| | **949** | **673** | **1,978** |

The discounted lease liability as at 31 December 2021 is £647k for the Bank (2021: £1,895k) and £923k for the Group.

Amounts recognised within the Statement of Comprehensive income in relation to finance leases are as follows:

| | Group 2022 £000 | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|---|
| Depreciation expense | (1,033) | (923) | (920) |
| Interest expense | (84) | (70) | (129) |
| Administrative expenses | (194) | - | - |

A financial commitment exists to pay rent for the New Malden and Northwich offices. The New Malden office has been exited giving rise to an impairment charge for the net book value (£194k) recognised through administrative expenses. The total rent for the year 2022 was £78k (2021: £78k).

## 32. Intangible Assets

See accounting policy in note 7.16.

| Group | Internally Generated Assets £000 | Software £000 | Licenses £000 | Core Deposit Intangible £000 | Total £000 |
|---|---|---|---|---|---|
| ***Cost*** | | | | | |
| At 1 January 2022 | **5,137** | **10,661** | **-** | **-** | **15,798** |
| Acquired as part of business combination | - | 2,855 | 11 | 1,960 | 4,826 |
| Additions | 1,595 | 3,241 | - | - | 4,836 |
| At 31 December 2022 | **6,732** | **16,757** | **11** | **1,960** | **25,460** |
| ***Amortisation*** | | | | | |
| At 1 January 2022 | 2,393 | 5,799 | - | - | 8,192 |
| Acquired as part of business combination | - | 1,201 | 6 | - | 1,207 |
| Charge for year | 1,120 | 2,413 | 5 | 594 | 4,132 |
| At 31 December 2022 | **3,513** | **9,413** | **11** | **594** | **13,531** |
| ***Net book value*** | | | | | |
| At 31 December 2022 | **3,219** | **7,344** | **-** | **1,366** | **11,929** |
| At 31 December 2021 | 2,744 | 4,862 | - | - | 7,606 |

During 2022, the Group recognised a Core Deposit Intangible on the acquisition of Wesleyan Bank Limited. Note 40 provides detail on the valuation technique and amortisation period of material assets and liabilities acquired.

| Bank | Internally Generated Assets £000 | Software £000 | Total £000 |
|---|---|---|---|
| ***Cost*** | | | |
| At 1 January 2022 | 5,137 | 10,661 | 15,798 |
| Additions | 1,595 | 3,181 | 4,776 |
| At 31 December 2022 | **6,732** | **13,842** | **20,574** |
| ***Amortisation*** | | | |
| At 1 January 2022 | 2,393 | 5,799 | 8,192 |
| Charge for year | 1,120 | 1,798 | 2,918 |
| At 31 December 2022 | **3,513** | **7,597** | **11,110** |
| ***Net book value*** | | | |
| At 31 December 2022 | **3,219** | **6,245** | **9,464** |
| At 31 December 2021 | 2,744 | 4,862 | 7,606 |

## 33. Other Assets

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Other receivables | 24,661 | 23,889 | 2,343 |
| Prepayments | 2,288 | 1,955 | 2,359 |
| Intercompany receivables | 63 | 73,654 | 18 |
| **Other Assets** | **27,012** | **99,498** | **4,720** |

Amounts receivable from group undertakings are unsecured and repayable on demand.

## 34. Other Liabilities

| | Group 2022 £000 | Bank 2022 £000 | Group and Bank 2021 £000 |
|---|---|---|---|
| Other taxation and social security | 1,121 | 1,121 | 4,277 |
| Other payables | 27,040 | 26,404 | 3,554 |
| Accruals | 28,840 | 26,449 | 13,749 |
| Margin account liabilities | 88,980 | 88,980 | 15,559 |
| Intercompany payables | – | 32,851 | – |
| **Other Liabilities** | **145,981** | **175,805** | **37,139** |

Accruals include interest accruals on customer deposits amounting to £16.9m (2021: £6.3m).

Margin account liabilities represents cash collateral received in respect of derivative exposures with a term exceeding three months.

## 35. Subordinated Liabilities

See accounting policy in note 7.19.

| Group and Bank | 2022 £000 | 2021 £000 |
|---|---|---|
| Tier 2 notes | 30,000 | 30,000 |
| Deferred acquisition costs | (26) | (182) |
| Accrued interest | 362 | 307 |
| **Subordinated Liabilities** | **30,336** | **30,125** |

## 36. Capital

In order to protect customers as a regulated bank, the Group is required to hold a minimum level of capital. To date this has been achieved through equity issuances to our investors, Additional Tier 1 notes, Tier 2 notes, and retained earnings. This also provides the investment to build and grow the Group. This section provides information on the Group's share capital, retained earnings and other equity balances. It also provides a breakdown of the Group's regulatory capital position.

### Managing capital risk

Capital risk is the risk that the Group has insufficient capital resources to meet its capital requirements and to absorb unexpected losses if they were to occur. Causes of inadequate capital could include lending origination volumes far exceeding expectations, suffering a high level of default on loans already made by the Group, or by having large unexpected operating costs for the business (including operational risk events).

Capital is one of the key measures of the Group and the Board sets capital risk appetite. Capital is actively managed with regulatory ratios being a key factor in the Group's planning processes and stress analysis.

The principal committee at which the Group's capital is scrutinised and managed is ALCO. The Board and BRC also receive metrics, monthly forecast of capital positions and commentary on capital risk. The Group refreshes its ICAAP on an annual basis, which includes a 4 year forecast of the Group's capital position.

The ICAAP is used to inform the future capital strategy and is submitted to the PRA following Board scrutiny and approval. Periodic shorter term forecasts are also undertaken to understand and respond to variations in actual performance against plan.

In order to avoid breaching a regulatory capital measure, a Board approved 'Management Buffer' of additional capital is imposed above the regulatory threshold. Unlike the regulatory limits, the 'Management Buffer' is designed to be utilised in a controlled manner when required.

The Group monitors its key capital metrics monthly, these include CET1 Ratio, surplus of capital resources over capital requirements and Leverage Ratio, and these allow the Bank to be able to effectively manage its capital resources.

Capital metrics are produced monthly to assess the current and projected capital. Since baseline projections are based upon future capital raises, an additional, stressed projection is also produced, which shows the potential capital position in the event capital raises were to prove impossible.

During 2022, the Group complied in full with all its externally imposed capital requirements. Note 37 provides information on capital and reserves per the IFRS balance sheet, with a reconciliation to the regulatory definition of capital.

## 37. Capital and reserves

### A. Share Capital

See accounting policy in note 7.22

| Issued and fully paid | Ordinary shares of £1 each | |
|---|---|---|
| | 2022 £000 | 2021 £000 |
| In issue at 1 January | 139,828 | 126,288 |
| Issued for cash | – | 13,540 |
| **In issue at 31 December** | **139,828** | **139,828** |

There were no Ordinary A shares issued during 2022 (2021: 13,539,999 Ordinary A shares of £1 at par).

The following shows the regulatory capital resources managed by the Bank.

| | Bank 2022 £000 | Bank 2021 £000 |
|---|---|---|
| Share Capital | 139,828 | 139,828 |
| Share Premium | 196 | 196 |
| Retained Earnings | 101,681 | 48,812 |
| Intangible Assets | (9,464) | (7,606) |
| IFRS9 Transitional Arrangement | 5,269 | 1,572 |
| Prudential Valuation Adjustments | (20) | (14) |
| Securitisation positions | (7,875) | (7,875) |
| Investment in subsidiaries | (49,422) | – |
| **Common Equity Tier 1 Capital** | **180,193** | **174,913** |
| Capital securities | 17,030 | – |
| **Total Tier 1 Capital** | **197,223** | **174,913** |
| Tier 2 Capital | 30,000 | 30,000 |
| **Total Capital** | **227,223** | **204,913** |

### B. Cashflow hedge reserve

The hedging reserve comprises the effective portion of the cumulative net change in fair value of hedging instruments used in cash flow hedges pending subsequent recognition in profit or loss as the hedged cash flows affect profit and loss (See note 21)

### C. Other equity instruments

See accounting policy in note 7.23

| Group and Bank | 2022 £000 | 2021 £000 |
|---|---|---|
| Capital Securities | 17,030 | – |
| Other Equity Instruments | 17,030 | – |

### Capital securities

£17m Additional Tier 1 securities were issued and fully paid up during 2022 (2021: £Nil) as part of the consideration for the acquisition of Wesleyan Bank Limited.

During the year ended 31 December 2022, the Group paid all interest when scheduled, totalling £1.4m (2021: £Nil). This is recognised directly in equity.

## 38. Related party transactions

Related parties of the Group include subsidiaries, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced, or for which significant voting power is held, by Key Management Personnel or their close family members. Key Management Personnel are defined as the Directors.

### A. Transactions with Directors

The compensation of the Directors is provided in note 13.

The following Directors during the year directly and indirectly held A and B ordinary shares in Hoggant Limited as at 31 December 2022:

| | Class A Shares | | Class B Shares | |
|---|---|---|---|---|
| Director | Number | £ Nominal Value | Number | £ Nominal Value |
| Matthew Wyles | 1,000,000 | 1,000,000 | 1,295 | 12.95 |
| Timothy Blackwell | 200,000 | 200,000 | 700 | 7.00 |
| Robert Sharpe | 150,000 | 150,000 | 189 | 1.89 |
| Robert East (resigned 30/06/2022) | 125,000 | 125,000 | 93 | 0.93 |

Total deposits of £278k, are held by the Bank from related parties of Non-Executive Directors as at 31 December 2022 (2021: £169k).

### B. Other related party transactions

The value of intercompany loans from the Bank to subsidiaries at the 31 December 2022 are provided in notes 33-34. The value of interest earned on intercompany loans is provided in note 8.

On the 31 March 2022 Wesleyan Bank Limited transferred an existing Block Discounting portfolio to the Bank at fair value which closely approximated its carrying value of £20m. Since this date the Bank has paid monthly service fees totalling £26k to Wesleyan Bank Limited for the continued servicing of the portfolio.

The value and nature of Management recharges to subsidiaries recognised through the Bank's Other income is provided in note 11.

## 39. Investment in subsidiaries

HTB has the following direct investments in subsidiaries as at 31 December 2022:

| | Country of Incorporation | Class of shares held | Ownership | Principal Activity | Registered address |
|---|---|---|---|---|---|
| **Hampshire Bank Limited** | England | A | 100% | Dormant | 55 Bishopsgate London EC2N 3AS |
| **Wesleyan Bank Limited** | England | A | 100% | Provision of banking services | 55 Bishopsgate London EC2N 3AS |

Hampshire Bank Limited and Wesleyan Bank Limited are unlisted entities and have an accounting reference date of 31 December.

HTB has the following indirect investments in subsidiaries as at 31 December 2022. The companies included in the following with 100% ownership are exempt from the requirements of Companies Act relating to the audit of accounts under section 479A, as the Bank has guaranteed the subsidiary companies under Section 479C of the Act.

| | Country of Incorporation | Registered number (Where S479A exemption is taken) | Ownership | Principal Activity | Registered address |
|---|---|---|---|---|---|
| **Syscap Holdings Limited** | England | 05740449 | 100% | Owns and licenses intangible fixed assets | 55 Bishopsgate London EC2N 3AS |
| **Syscap Limited** | England | 02471568 | 100% | Broker- introduction of Finance | 55 Bishopsgate London EC2N 3AS |
| **Syscap Group Limited** | England | 03132650 | 100% | Dormant | 55 Bishopsgate London EC2N 3AS |
| **Syscap Leasing Limited** | England | 02718043 | 100% | To arrange lease finance and the provision of associated services | 55 Bishopsgate London EC2N 3AS |
| **Serco Paisa Limited** | England | - | 50% | JV with Serco Group PLC to effect finance for Serco Leisure Operating Ltd | CI Tower St Georges Square New Malden Surrey, KT3 4TE |

## 40. Acquisition of subsidiaries

### A. Acquisition of Wesleyan Bank Limited

On 28 February 2022 Hampshire Trust Bank PLC ("HTB") acquired 100% of the shares and voting rights of Wesleyan Bank Limited ("WBL").

Included within identifiable assets and liabilities acquired at the date of acquisition of WBL are systems, processes and an organised workforce. The Group has determined that together the acquired systems and processes significantly contribute to the ability to create revenue. The Group has concluded that the acquired set is a business.

The acquisition was driven by HTB's strategy to leverage its existing, proven business model and operating platform, to enhance profitability and drive shareholder value. Specifically, the transaction increases HTB's scale, creates a more profitable business and facilitates HTB's ongoing investment in technology, process effectiveness and capability in a highly capital efficient manner.

### B. Consideration transferred

The following table summarises the acquisition date fair value of each major class of consideration transferred:

| | £000 |
|---|---|
| Cash | 32,000 |
| Capital securities (Additional Tier 1 notes) | 17,176 |
| **Total consideration transferred** | **49,176** |

### C. Acquisition related costs

The group incurred transactions costs relating to legal fees and due diligence costs. These costs have been included in administrative expenses during 2021. The Group also incurred £250k of stamp duty costs on acquisition which have been recognised as administrative expenses within the Group's income statement but capitalised as part of the investment in subsidiary in the Bank's Statement of Financial Position.

### D. Details of identifiable assets acquired and liabilities assumed

The following table summarises the recognised amounts of assets acquired, and liabilities assumed at the date of acquisition.

| | £000 |
|---|---|
| Loans and Advances to Banks | 65,482 |
| Investment Securities | 34,988 |
| Loans and Advances to Customers – at amortised cost | 489,235 |
| Tangible Fixed Assets | 3,638 |
| Right of use assets | 382 |
| Intangible Assets | 3,617 |
| Other Assets | 8,348 |
| **Total assets** | **605,690** |
| Central Bank Facilities | (96,769) |
| Customer Deposits | (404,875) |
| Finance Lease Liability | (385) |
| Other liabilities | (5,777) |
| **Net assets acquired** | **97,884** |

The Group has reviewed the need to re-assess and adjust the fair value assessment that was undertaken upon the completion of the transaction. However, there is no new information identified which would affect the original FV assessment.

### E. Identifiable assets and liabilities acquired

#### Measurement of Fair values

The valuation techniques used for measuring the fair value, and amortisation period of fair value adjustments of each material asset and liability class acquired were as follows:

| Assets Acquired | Valuation technique | Amortisation profile |
|---|---|---|
| Loans and advances to Customers | Discounted cash flow, estimated present value of future cash flows | Amortised using effective interest rates over behavioural life |
| Intangible Assets | Discounted cash flow, estimated present value of future cash flows | 2.5 years straight line basis |
| Customer Deposits | Discounted cash flow, estimated present value of future cash flows | Amortised using effective interest rates over behavioural life |
| Central Bank Facilities | Discounted cash flow, estimated present value of future cash flows | Amortised using effective interest rates over behavioural life |
| Deferred tax asset | Calculated in reference to the intangible asset valuation | 2.5 years straight line basis |

### F. Gain on bargain purchase

The purchase of WBL resulted in a gain due to HTB being in a better position as a Bank to realise the fair value of the net assets acquired compared with the Seller. The transaction was conducted at a level that enabled the Seller to achieve their objective of releasing capital and providing them with the opportunity of deploying the capital into investment opportunities more aligned with their go-forward strategy. As such a gain on bargain purchase arising from the acquisition has been recognised as follows:

| | £000 |
|---|---|
| Total consideration transferred | (49,176) |
| Fair value of identifiable net assets | 97,884 |
| **Total gain on bargain purchase** | **48,708** |

Gain on bargain purchase has been recognised immediately through the Group Statement of Comprehensive Income.

## 41. Ultimate parent company

The Bank is a subsidiary undertaking of Hoggant Limited, which is incorporated in England and Wales and is the largest company in which the results of the Bank are consolidated. The majority of Hoggant Limited's equity is owned by Hoggant L.P. a limited partnership incorporated in Guernsey. Hoggant L.P. is not controlled by a single party and is majority owned by funds managed by Alchemy Special Opportunities (Guernsey) Limited. The consolidated financial statements of Hoggant Limited are available on request from 55 Bishopsgate, London EC2N 3AS.

## 42. Post balance sheet events

On 27 June 2023 the Bank issued a further £25m of Subordinated Tier 2 notes. The notes pay an annual fixed coupon, payable semi-annually in arrears and have a maturity date of 27 December 2033.

# 5 Glossary

## Glossary

| | |
|---|---|
| **Average principal employed** | Calculated as the average Loans and Advances to customers held at amortised cost and fair value in reference to current year end and prior year comparative balances within the Statement of Financial Position. |
| **Blended cost of funds (after hedging)** | Rate of interest payable on average funding excluding Tier 2 adjusted for interest on interest rate swap liabilities. |
| **CBILS** | Coronavirus Business Interruption Loan Scheme |
| **Common Equity Tier 1 Ratio (CET1 Ratio)** | The Common Equity Tier 1 ratio is calculated as common equity tier 1 capital (note 37) divided by risk-weighted assets as reported per the current year end COREP Submission. |
| **Cost of Risk** | Cost of risk is calculated as impairment losses on financial assets and net loss or gain on loans held at fair value through profit or loss (note 11) divided by average principal employed. |
| **Cost to Asset Ratio** | Administrative expenses divided by average principal employed |
| **Cost to Income ratio** | Cost to Income Ratio is calculated as administrative expenses divided by operating income excluding net gain or loss on loans held at fair value through profit and loss. |
| **Coverage Ratio** | Calculated as the allowance for impairment expressed as a percentage of gross loans and advances at amortised cost. |
| **CPI** | Consumer Price Index |
| **CRD IV** | Capital Requirements Directive |
| **CRE Price** | Consumer Retail Estate Price |
| **Customer Satisfaction Index** | This is a measure of customer satisfaction and the quality of customer service. The index is independently compiled by the Institute of Customer Services. |
| **EAD** | Exposure at default |
| **ECL** | Expected Credit Losses |
| **ESG** | Environmental, social and governance |
| **FVOCI** | Fair value through other comprehensive income |
| **FVTPL** | Fair value through profit and loss |
| **GDP** | Gross Domestic Product |
| **Gross income margin** | Calculated as total interest and similar income (note 8), fees and total fees and commission income (note 9) and Net loss or gain on loans, other financial assets at fair value through profit or loss (note 10) and other income (note 11) divided by average principal employed. |
| **HPI** | House Price Index |
| **IAS** | International Accounting Standard |
| **IASB** | International Accounting Standard Board |
| **IBOR** | Interbank Offered Rate |
| **ICAAP** | Internal Capital Adequacy Assessment Process |
| **IFRSs** | International Financial Reporting Standards |
| **ILAAP** | Individual Liquidity Adequacy Assessment Process |
| **ILTR** | Indexed Long-term repo |
| **ISA** | Individual Savings Accounts provided by the Savings division |
| **KMP** | Key Management Personnel |
| **Leverage ratio** | The leverage ratio is calculated as Common Equity Tier 1 capital divided by the sum of total assets (excluding intangibles). |
| **LGD** | Loss given default |
| **LIBOR** | London interbank offered rate |
| **Liquidity Coverage Ratio ('LCR')** | The ratio of the stock of high-quality liquid assets to expected net cash outflows over the following 30 days. High-quality liquid assets should be unencumbered, liquid in markets during a time of stress, and ideally, central bank eligible. |

| | |
|---|---|
| **Loan to Deposit ratio** | Calculated as loans and advances to customers divided by customer deposits. |
| **LTI** | Long term Incentive |
| **LTV** | Loan-to-value ratio |
| **MRT** | Material Risk Taker |
| **Net Interest Margin (NIM)** | Calculated as net interest income divided by average principal employed. |
| **Net Revenue Margin** | Calculated as operating income excluding net loss or gain on loans held at fair value through profit or loss, divided by average principal employed. |
| **Net Promoter Score** | This is an index ranging from -100 to 100 that measures the willingness of customers to recommend a company's products or services to others. It is used as a proxy for gauging the customer's overall satisfaction with a company's product or service and the customer's loyalty to the brand. |
| **OCI** | Other comprehensive income |
| **PD** | Probability of default |
| **POCI** | Purchased or originated credit impaired |
| **PPE** | Property, plant and equipment |
| **RAF** | Risk Appetite Framework |
| **Return on equity (post-tax)** | Return on equity (post-tax) is calculated as profit post tax for the year divided by average equity. |
| **Return on Required Equity** | Return on Required Equity is calculated as profit post tax for the year divided by average required equity. |
| **Required Equity** | The amount of regulatory equity needed to achieve the required minimum common equity tier 1 ratio. |
| **RFR** | Risk-free rate |
| **RMF** | Risk Management Framework |
| **Risk-weighted asset (RWA)** | A measure of a bank's assets adjusted for their associated risk. Risk weightings are established in accordance with the Basel rules as implemented by CRD IV and local regulators. |
| **Risk-weighted asset (RWA) density** | The ratio of RWA to customer loans provides a measure of riskiness of assets. |
| **SECR** | Streamlined Energy and Carbon Reporting |
| **SMF** | Senior Management Function |
| **SPPI** | Solely Payments of Principal and Interest |
| **T1** | Tier 1 |
| **T2** | Tier 2 |
| **Total Capital Ratio** | Common Equity Tier 1 plus Tier 2 and Additional Tier 1 Equity divided by risk weighted assets. |
| **TFSME** | Term Funding Scheme with Additional Incentives for SMEs |
| **Underlying Gross Income Margin** | Calculated as total interest and similar income (note 8), fees and total fees and commission income (note 9) and Net loss or gain on loans, other financial assets at fair value through profit or loss (note 10) and other income excluding Management recharges (note 11), divided by average principal employed. |
| **Underlying Net Revenue Margin** | Calculated as operating income excluding net loss or gain on loans held at fair value through profit or loss (note 10) and Management recharges (note 11), divided by average principal employed. |
| **Underlying Cost to Asset Ratio** | Administrative expenses net of Management recharges (note 11) divided by average principal employed |
| **Underlying Income Ratio** | Calculated as administrative expenses net of Management Recharges (note 11) divided by operating income excluding net gain or loss on loans held at fair value through profit and loss (note 10) and management recharges (note 11). |

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HTB

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