Annual report and financial statements

30 September 2022

Registered number 00743437

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A.C.I.B.

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M.B.A.,
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Aileen Wallace
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M.C.B.I
C.I.R.M.
A.M.B.C.S.

Penny Bickerstaff
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(appointed 22
September 2022)

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(resigned 28
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1 Strategic Report

Chairman's Statement

In July 2021, the Board and the Shareholder approved a five-year strategic plan which we acknowledged was ambitious but achievable as the UK recovered from recession.

The past year has remained a challenge for many businesses across the UK despite the steady exit from the restrictions imposed in support of the COVID-19 response.

Inflationary pressures not seen for a generation are being felt across the globe and the UK is no exception. The impact of COVID-19, followed by Russia's military conflict with Ukraine coupled with a somewhat unclear fiscal response, means that the overall business environment and outlook is far from certain.

The management response to this has been proactive and effective, providing clear leadership and direction to our colleagues who, once again, have responded exceptionally well. The Board are very appreciative of their continued professionalism and dedication to providing an excellent experience for our customers.

In July 2021, the Board and the Shareholder approved a five-year strategic plan which we acknowledged was ambitious but achievable as the UK recovered from recession. While the direction agreed remains the same, we have also recognised that the context for the plan has changed quite considerably from the original setting, and so the challenge to deliver a return to the Shareholder in excess of the cost of capital is unlikely to be achieved. As a result, the Board asked management to review the execution of that plan.

A key element of that review was the extent to which we would invest in our historically successful commercial proposition. In the July 2022 board we agreed that we would increase the focus on this by growing the commercial assets portfolio, with the emphasis on the retail proposition being on the markets where our specialism allows the Bank to target effective returns on capital over volume.

> Our Commercial proposition has already been expanded and is targeted at professional developers to support them throughout the development cycle.

Our commercial proposition has already been expanded and is targeted at professional developers to support them throughout the development cycle. In February this year we re-entered the market with a range of commercial investment, stretch senior finance, acquisition bridge and sales bridge products, and we have plans to expand this proposition further in the coming year.

Our Commercial team has demonstrated their expertise through the recent cycle by establishing close relationships with a limited number of partners. This allows us to stay close to the customers and ensure the focus is on high quality assets rather than volume. It is this approach which gives confidence for the continued expansion and growing contribution to the Bank of the commercial business going forward.

Turning to our retail lending, the year has seen an above target lending performance in excess of £500m, with later-life lending and holiday buy-to-let leading the way. The importance of remaining true to our goals of being a specialist lender means the focus for the remainder of the plan period will be to **identify segments of the market where our flexibility, experience and capability can be combined to meet those specific customer needs while focussing on higher margin, higher return products rather than volume lending as increasing our proposition is a key enabler of effective margin management.**

Improving our savings proposition directly to our customers through a broader offering, including instant access accounts enabled by a digital service remains a number one priority. Funding costs have risen quickly across the market, and this has undoubtedly put pressure on net margins across many banks, with the Bank being no exception. This year we have seen our deposits from customers increase to in excess of £1.4bn with significant improvements in productivity with monthly deposits nearly double the maximum capacity from a year before. Our retention rates remain high but the investment in our platform will target an improvement on this already impressive performance.

> A key goal for the five year strategy is to deliver an upper quartile customer experience and good progress has been made this year.

A key goal for the five-year strategy is to deliver an upper quartile customer experience and good progress has been made this year, both in terms of the delivery of enabling technology and the training and development of our customer facing colleagues. The customer experience is being actively measured across our Retail Mortgage and Savings teams and both are showing positive NPS scores of 65 and 64 respectively. Our Trustpilot ratings have improved to a 4.7 rating with 82% of the reviews at a maximum of five, improving our overall rating to fourth out of the 47 companies listed in the banking sector.

The Board recognises that our people are critical to delivering our stretch service goals and, with this in mind, I am delighted that we continue to work with the Financial Services Culture Board (FSCB) to be able to listen to and engage with our colleagues to identify areas where we can improve. **This is the third year of the survey and we are seeing a steadily improving trend across all themes, with both 'shared purpose' and 'ability to speak up safely' benchmarking very well across industry peers and demonstrating a commitment to an open, respectful culture.**

Nevertheless, the survey also highlights that we can do more to help our colleagues with better systems and processes so we continue to invest in our technology and our people to make the overall experience easier, more intuitive and more engaging. Our objective is to create the environment for our colleagues to be able to deliver a more flexible, more human service where the customer values it.

• Chairman's Statement (continued)

Improving productivity while simultaneously improving the customer experience is a key strategic driver of our five-year plan.

The priority for our Change teams has been on the Digital Savings Programme (DSP), effectively the digitalisation of our savings proposition which will improve the customer journeys, increase the productivity and efficiency of our colleagues and enable the Bank to launch a broader range of products such as instant access. **DSP is a key focus for the Board and a key enabler of the five-year strategy**. While there have been some technical issues along the way, meaning some delays, the plan is to launch the new platform early in 2023.

In the retail mortgage arena, the migration of the outsourced servicing to our in-house team will enable us to improve the service while operating more efficiently and to increase our customer retention levels. In addition, a number of propositional changes have been launched such as capital and interest, CRM workflow and a change tool to reflect the more dynamic economic and competitive environment which we currently experience. **As a broker enabled lender, relationships with mortgage introducer professionals remain critical to our progress so we have delivered a broker portal to make the whole experience of working with the Bank easier, faster and more under the control of the broker community**.

In 2021, the Board approved our five-year plan in respect of our environmental, social and governance (ESG) goals with the key focus of achieving carbon neutrality for direct emissions by the end of 2021, with further work during 2022 to fully understand the downstream impacts on scope three financed emissions. In conjunction with the Carbon Trust, we purchased carbon credit offsets as a first step towards this move to net zero, with our energy suppliers having moved to renewable sources to reduce scope one emissions. We have progressed our understanding of scope three emissions, but more detailed work is required in the coming year. The Section 172 statement included on page 7 includes further information with regards to the Bank's impact on the environment and the steps being taken to monitor and reduce this impact.

> "The first line risk team has been strengthened during the year across a number of disciplines, including Compliance, Quality Assurance, Credit Risk and Financial Crime.

The management of strategic risk has seen the Bank execute the previous plans to de-risk the Balance Sheet, the sale of the Reversion book to a fellow subsidiary of The Carlyle Trust being the final piece of the jigsaw. Going forward, new and emerging risks have been identified primarily around the economic outlook, with the impact of higher inflation yet to be felt in terms of interest rates and the knock-on impact to living standards, the potential for rising unemployment and to ongoing affordability across all markets.

More specifically for the Bank, management has recognised the need to strengthen our operational resilience planning, together with the outsourcing policy and management. Our board risk appetite has been reviewed and is operating effectively and will remain under continual review as we further develop our specialist lender strategy. **The first line Risk team has been strengthened during the year across a number of disciplines, including compliance, quality assurance, credit risk and financial crime**. As a result of this increased level of capability, our second line team has been able to increase the range and volume of oversight work with plans in train to strengthen specific areas such as IT, change and financial risk. Further information in relation to the activities of the Risk team and our approach to risk management can be found on page 16.

Finally, I would like to take the opportunity to say thank you both personally and on behalf of my colleagues on the Board to Helen Molyneux who retired from the Board in March this year. Helen made a hugely valuable contribution to the development of the strategy, to the culture of the business and to the governance and professionalism across the Bank.

I would also like to formally welcome Penny Bickerstaff to the Board as our senior independent director. Penny brings a varied and extensive range of insights to the Board which will add a huge amount to our ongoing effectiveness, with experience of holding senior roles in large companies as well as running her own businesses across a number of sectors such as banking, media and finance.

The NEDs have continued to work collaboratively and effectively throughout the year, and the addition of Penny only adds to the professionalism and competence of the Board to exercise robust challenge and oversight.

Graeme Hughes
Chairman

9 December 2022

Our business, social responsibility and stakeholder engagement

We are a privately owned bank **seeking to make life better for customers and society in the moments that matter.**

What we do

We are a specialist UK lending and savings bank focused on specialist finance and savings. We differentiate ourselves by concentrating on markets where our expert knowledge, judgement and personalised approach to lending offer us a competitive advantage.

Retail mortgages

The Bank's specialist retail mortgage business is focused on complex income, later life lending, holiday buy-to-let and professional income plus products.

The Bank has had to move quickly as rates have risen significantly for the first time in numerous years.

We work closely in partnership with our trusted network of intermediaries, serving customers looking to invest in a holiday home through our holiday let mortgage, and personal customers through our complex income and later life mortgages.

Our range of retail mortgages allow customers to either repay down the capital or choose interest only. Our interest only mortgages allow customers to repay the mortgage with or without a fixed-term end. Our later life mortgages are available to those over 50, a growing market that we are committed to serving.

2022 has been a year of focus, continuing to build on the service delivery improvements we made in 2021 and continuing to place our customers at the heart of everything we do. We continue to engage, value and respond to feedback from the broker community, delivering a range of product updates and service enhancements throughout the year. We work closely with them to ensure the products we offer deliver for our customers whilst providing flexibility in a notoriously rigid market. This is essential as we continue to evolve our product offering in 2023.

We have also committed significant investment in our team, strengthening our expertise and capability to serve and respond to the market. This continues to pay dividends in the feedback we receive from brokers.

The rising interest rate environment has meant that **the Bank has had to move quickly as rates have risen significantly for the first time in numerous years**. We will continue to monitor rates as they are forecast to continue rising in 2023.

Commercial lending

Our core purpose is to support experienced, serially active investors and developers of real estate assets, in residential schemes. This means that we impact positively on the communities into which we lend, by helping our customers deliver much needed new homes for sale or rent, as well as regenerating areas.

As the economy continues to emerge from the COVID-19 pandemic, the Commercial team has been developing new product offerings for our customers and we are confident our updated offerings will prove attractive to our target market. We will be looking to grow our lending volumes and secure new customers, whilst continuing to service our existing client base.

Our customers remain central to everything we do and we are continuing to invest time, effort and money in improving the efficiency of our systems, processes and people as we strive for excellent client experience across all areas of our business.

Savings

Customer savings are, and will remain to be, the most important part of our funding base.

Throughout 2022 we have continued our commitment to support more customers through our online channels and have continually monitored our savings rate in the current rising interest rate environment.

The continued investment in digital capabilities, simplifying processes and leveraging technology to quicken our service is **continuing to drive positive feedback** from current and new customers evidenced in our 'excellent' Trustpilot score.

During the next twelve months we aim to make significant investment in our technology infrastructure to provide a leading digital experience to give our customers even more control over how they engage with us. Whilst allowing customers more flexibility to manage their finances, we will provide an experience that is simple and easy but also personalised in the moments that matter. We know that our customers appreciate the value of human touch and that is why we will continue to ensure our experts are available to answer any queries.

Grow our presence in the personal savings market providing an excellent digital experience.

We continue to manage over £1bn of our customers' savings balances and will continue to **grow our presence in the personal savings market providing an excellent digital experience**, attractive interest rates and products and services that meet our customers' needs.

The Bank is also a participant in the Bank of England's Term Funding Scheme (TFSME), which provides a cost-effective source of funding in the form of central bank reserves to support additional lending to the real economy.

Colleagues

Our people are central to the value we deliver for our customers and the key to creating a strong experience for our customers. We remain committed to building a culture where people thrive through rewarding talent and performance.

- **Learning and Development:** Throughout this year we have continued to **develop our learning platform and range of development programmes** to help colleagues flourish and grow in their careers at the Bank. We have invested in our leadership development offering a range of Institute of Leadership Management (ILM) leadership and coaching qualifications. Whilst also investing in the technical skills across the business to support our Customer Experience (CX) programme, financial and fintech capability. We continue to support our future talent through our internal succession talent plans, the Welsh Financial Services Graduate programme and supporting career paths and progression which has created new opportunities for many of our team.
- **Colleague Wellbeing:** We have continued to support our colleagues through our **'Healthy Hodge' scheme**, providing resources and support for maintaining healthy minds, bodies, families, finances, and connections. We have improved this by investing in a range of training programmes to increase our mental health awareness and support our hybrid working approach for our leaders and colleagues.
- **Flexible Benefits:** We have strengthened the processes and frameworks we have in place around reward & recognition, **drawing a stronger link between reward and performance** for colleagues. Moving into the new year we will review our flexible benefits offering again with colleagues, allowing us to ensure we have the most effective package we can for both current and future colleagues.
- **Inclusivity and Flexibility:** Building on successes from the previous year, we have been working towards further improvements that will see us make further strides towards being a truly inclusive workplace. Through our core hybrid working model, flexibility remains a key aspect of that as a commitment to empowering our people to work in a way that works for them as often as possible. Alongside this, we are exploring ways to embed a culture of supportive allyship across all teams at the Bank. The Equality, Diversity & Inclusion (ED&I) network provides information to members from across the business to widen the focus of inclusivity across all facets which can impact the feeling of exclusion.

We hope that this will help to increase representation across the Bank, and we are seeing more colleagues updating their Diversity and Inclusion (D&I) data fields in the HR system.

Corporate Social Responsibility

Throughout 2022 we have deepened our commitment to helping older people live safely.

We have increased our focus on vulnerability, with all our frontline colleagues receiving specific training to equip them with the skills and knowledge to ensure that the needs of our most vulnerable customers are accommodated.

Stakeholder Engagement – S172 Statement

The Companies Act 2006 requires the Directors of the Bank to act in the way he or she considers, in good faith, would be most likely to promote the success of the Bank for the benefit of its stakeholders as a whole. In doing so, s172 requires a Director to have regard, amongst other matters, to the:

• Our business, social responsibility and stakeholder engagement (continued)

- likely consequences of any decisions in the long-term;
- interests of the Bank's employees;
- need to foster the Bank's business relationships with suppliers, customers and others;
- desirability of the Bank maintaining a reputation for high standards of business conduct;
- impact of the Bank's operations on the community and environment; and
- interests of the Bank's Shareholder.

In discharging its s172 duties, the Directors of the Bank have regard to the factors set out above. The Board also has regard to other factors which it considers relevant to the decisions it makes. The Board acknowledges that not every decision it makes will necessarily result in a positive outcome for all of the Bank's stakeholders. By considering the Bank's purpose, vision and values together with its strategic priorities and having a process in place for decision-making, the Board aims to make sure that its decisions are consistent.

The Board delegates authority for the day-to-day running of the business to the Bank's CEO and, through him, to the Executive Committee to set, approve and oversee the execution of the Bank's strategy and related policies. The Board reviews matters relating to financial and operational performance, business strategy, key risks, stakeholder-related matters, compliance, legal and regulatory matters, over the course of the financial year. This is supported through the consideration of reports and presentations provided at board meetings and reviewing aspects of the Bank's strategy at least twice a year. A high-level summary of the Bank's strategy can be found in the Chairman's Statement on page 5.

The Bank has a number of key stakeholder groups with whom it actively engages. Listening to, understanding and engaging with these stakeholder groups is an important role for the Board in setting strategy and decision-making. The Bank recognises its obligations and requirements to be a well-controlled financial services business, compliant with regulation and delivering good customer outcomes. The Regulators are consulted and kept closely informed in relation to key decisions made by the Board, as appropriate. A summary of how the Board engages with customers, employees, suppliers, the community, and the Shareholder is provided on the subsequent pages.

Our Customers

As a customer-centric business the Bank uses a range of methods to involve and engage with our customers. The Board values feedback from customers to ensure the Bank is providing them with what they want and need.

The Bank works closely with its broker community to ensure the products we design are needed and add value for customers. We capture feedback through a variety of surveys and capture reviews through Trustpilot as an independent measure of our service and experience as and when customers interact with the Bank.

2022 has been a year of continued progress as we accelerate our commitment to **putting the customer at the heart of everything we do**. We have engaged our customer and broker communities in the evolution of our product and service offerings, continuing to champion the needs of our audiences in helping them achieve their goals and ambitions.

The Bank continues to invest heavily in technology to improve our operational and digital capability which is vital in delivering great service to our customers. This investment brings efficiency and scalability to our operations. In 2022, the Bank has continued to invest in a new banking platform that will underpin our entire business model, improving efficiencies and capabilities for our teams, whilst delivering first class experiences to our customers. Together with a new online savings application journey that we have invested in, 2023 will see further enhancements to our offering.

Our Employees

We continue to invest in our people, with leadership support and mentoring across the business. This commitment will enhance strategic leadership as well as strengthening capability at multiple levels throughout the organisation.

The Board has appointed a designated non-executive director to assist with providing a link between employees and the Board and regularly attends colleague engagement meetings to provide a summary to the other directors on the output of such meetings. During 2022, the Board consulted employees in relation to flexible working arrangements and the new annual reward plan.

Our Suppliers

Our suppliers play an important role in the operation of the Bank's business to enable the delivery of an effective and efficient business model.

During 2022 several material contracts were presented to the Board for approval, covering both new relationships and contract renewals. In approving these contracts, the Board considered the strategic value of the relationships as well as looking at the customer impacts, risk exposure, legal and compliance considerations and financial implications. The Bank has a framework in place which provides a consistent and proportionate approach to the procurement and management of suppliers to ensure that it can effectively engage, manage and terminate, where appropriate, supplier relationships.

Our Shareholder

A Shareholder Engagement policy has been agreed and adopted by the Board, detailing the Shareholder's expectations of the Bank and those matters that require shareholder approval or shareholder consultation, to support appropriate Governance and oversight.

The Board provides updates to and engages with the Shareholder of the Bank regularly to obtain a clear understanding of its views and requirements. During 2022, the Shareholder was consulted in relation to the revised strategic plan, the new annual reward plan and the disposal of the reversion portfolio to a separate subsidiary of the Group.

Our Community

Throughout 2022 we have continued to make a difference to the lives of others through our corporate social responsibility commitment. The Bank has a focus on supporting older people live safe lives through partnering with Hourglass, a charity that works to challenge and prevent the abuse of older people. Additionally, every member of our team benefits from up to four days off work per year to support good causes with the Bank's 'Four to do More' initiative.

The Environment

A Climate Change policy is being developed outlining governance structures, disclosures, risk management approach and the SMF responsibility in the business. An internal working group has been established to develop the Bank's approach and understanding of the risk posed by climate change. Climate change is also being considered specifically as part of the regulatory risk management documents; Internal Capital Adequacy Assessment Process (ICAAP) & Internal Liquidity Adequacy Assessment Process (ILAAP).

The Bank continues to report Green House Gas (GHG) emissions to comply with the Streamlined Energy & Carbon Reporting (SECR) initiative.

We tasked The Carbon Trust to calculate our GHG emissions under the rules laid out by the World Resources Institute's GHG Protocol Corporate Accounting and Reporting Standard. This enables us to ensure the accuracy of these disclosures and to monitor our own performance in reducing our carbon footprint. We are focused on making the Bank a more sustainable organisation, both in terms of our carbon footprint and the products that we offer. The figures presented below are for the years to June 2022 and June 2021.

Scope 1 – direct GHG emissions

Includes emissions from activities owned or controlled by the Bank that release emissions into the atmosphere. Examples include emissions from combustion in owned or controlled boilers and vehicles.

Scope 2 – energy indirect emissions

Includes emissions from own consumption of purchased electricity, heat, steam and cooling. These are a consequence of the Bank's activities but are from sources not owned/controlled.

Scope 3 – other indirect emissions

Emissions that are as a consequence of the Bank's actions, but the source is not owned or controlled, and which are not classed as scope 2 emissions.

The Bank is compliant with the Streamlined Energy and Carbon Reporting standard (SECR).

The growth in emissions in 2022 is primarily as a result of colleagues returning to work in the office on a flexible basis, following easing of the COVID-19 restrictions.

All the Bank's operations are UK based. The Bank's GHG emissions are reported in (tCO2e) and usage in (kWh). GHG emissions per employee and income are reported as intensity metrics, for future ease of comparison.

Further information with regards to the Bank's assessment of the impact of climate change and its approach to risk management can be found on page 22.

Scope	GHG Emissions Source	2022	2021
Scope 1 (tCO2e)	Fuel (Buildings)	52.9	54.9
	Refrigerants	5.3	-
Scope 2 (tCO2e)	Electricity	16.8	17.0
	Company electric vehicles	-	-
Scope 3 (tCO2e)	Business travel	23.7	4.9
	Employee commuting	83.7	9.5
	Employee working from home	132.0	135.3
	Other	0.5	0.1
Total location based GHG emissions (tCO2e)		314.9	221.7
Average number of employees		354	321
GHG per employee (tCO2e)		0.89	0.69
GHG use per £m income (tCO2e)		6.2	5.6

Chief Executive Officer's Statement

I am lucky to lead an organisation with such great people, a clear strategy and an alignment of purpose and vision making us uniquely placed to deliver for our customers.

I am incredibly proud to present the Bank's Annual Report and Financial Statements for 2022. A year which has seen continued development against our strategic ambitions, against a challenging backdrop with the cost-of-living crisis along with the terrible events in Ukraine. I am lucky to lead an organisation with such great people, a clear strategy and an alignment of purpose and vision making us uniquely placed to deliver for our customers.

Performance

Throughout 2022 we have continued to build on our foundations in our specialist markets for savings, mortgages and commercial lending. Underlying profitability at an operating level reflects continued improvement in our business as we continue to grow our balance sheet.

During the year we have increased our commercial real estate offering, launching new products aimed at providing a greater range of solutions for our customers, including experienced property investors and developers. We have invested in our team with several new team members joining to deliver on our commercial strategy and I am incredibility excited to see the business develop in the coming years.

In retail mortgages, we have launched a new product aimed at professionals and seen a record year, with mortgage completions in excess of £500m across our professional, holiday buy-to-let, traditional buy-to-let and later life offerings. We will continue to aim at segments where our experience and capability coupled with an underserved customer base best meets our ambitions. We have also continued to grow our retail savings book as we ensure we are a safe and trusted home for customers' savings.

> We are acutely aware of our role as a responsible lender and a responsible employer and are committed to supporting our customers and colleagues through this challenging time.

Customers

We continue to focus on delivering brilliant experiences for our customers through every single interaction in whichever way our customers want to deal with us. **Our Trustpilot score of "excellent" with 94% reviews either "excellent" or "great" show the value we provide to our customers every day** and with new functionality planned for 2023 and beyond we will continue to always focus on delivering value and be a trusted provider for all our customers.

I would like to say thank you to our customers and wider stakeholder base for the trust you have placed in us; we will continue to do everything we can to earn your continued support.

Colleagues

I want to take this opportunity to extend my appreciation to all of our dedicated and talented colleagues, I feel proud every day of their commitment to delivering for our customers.

Our colleagues have also been impacted by the cost of living challenges with the cost of essentials, energy, food and transport all increasing at such high levels, which disproportionately effects those on lower incomes. To support colleagues alongside the annual pay reviews, I am also pleased to say that we could support our band one to three colleagues with a £1,000 payment to reflect the extraordinary environment we are working in and as a gesture demonstrating the Bank will always support its people in the moments that matter most.

Technology and composable architecture

Our investment in technology continues in line with our strategy to use the best components and a modular approach so that we can move forward at pace and with real agility.

I am looking forward to 2023 with our investment in a new banking platform enabling us to launch new savings products such as easy access, as well as improving the customer journey, through a new mobile application and more seamless integration enhancing functionality for our customers.

In retail mortgages, the focus has been on delivering new functionality for customers and our intermediary partners and to build efficiency into our processes. From a technology perspective we are now able to respond immediately to changes in the interest rate environment and have made enhancements to our re-mortgaging and additional borrowing customer journeys.

The outlook

There is no doubt the UK is facing a significant challenge with inflation at levels not seen for more than 40 years, coupled with interest rates rising at a pace not seen for 30 years, it's a challenging time for everybody but especially those on lower incomes.

This outlook means that the specialist banking sector in which we operate is facing an economic cycle many people have not seen before. We are not immune to those challenges; and our customers and colleagues will also face them in the next 12-18 months, but our long tradition and history, combined with significant financial strength, means we are well placed to navigate the difficult times ahead. **We are acutely aware of our role as a responsible lender and a responsible employer and are committed to supporting our customers and colleagues through this challenging time.**

David Landen
Chief Executive Officer
9 December 2022

Chief Financial Officer's Report

The Bank's continued investment in software will enable it to respond more quickly to changes in interest rates.

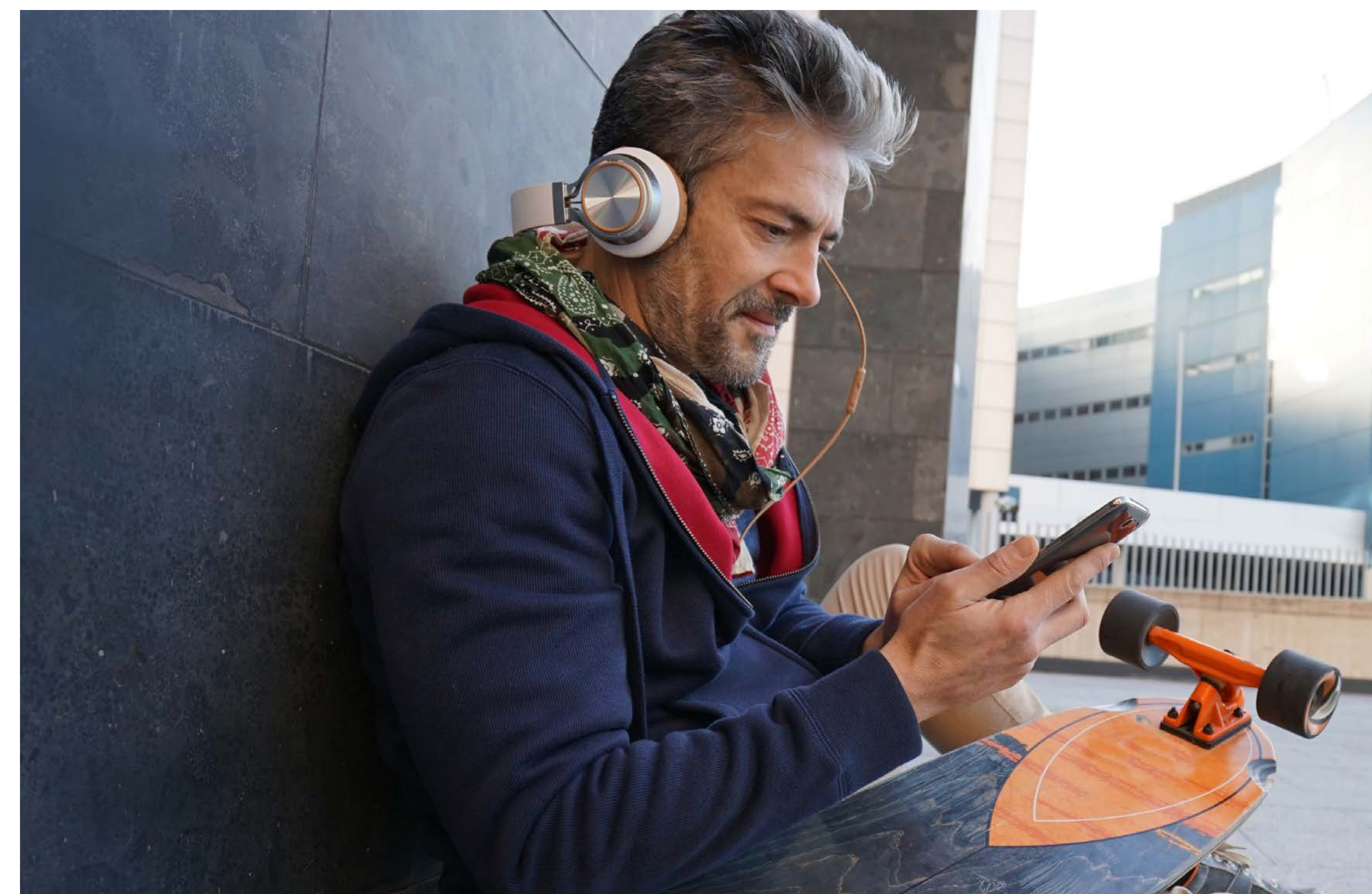
This is my first full year as CFO, following my appointment in September 2021. As with 2021, 2022 remained a challenging year; the economic effects of the COVID-19 pandemic eased towards the end of the first half of the year, only to be replaced with inflationary pressures, partially caused by the impact of the war in Ukraine on food and energy prices.

In response to these factors, the Bank of England has raised interest rates seven times in the Bank's financial year, with a further increase announced in November 2022. Forecasts predict that inflation will peak by the end of the calendar year with a resultant recession in 2023.

An overview of the Bank's financial performance is provided below:

Income statement

	2022 £m	2021 £m
Interest receivable	50.5	39.6
Interest payable	(21.1)	(22.0)
Net interest income	**29.4**	**17.6**
Net fees and commissions receivable	2.5	2.5
Investment and other operating income	6.7	6.1
Net operating income	**38.6**	**26.2**
Administration expenses	(34.2)	(25.9)
Depreciation and amortisation	(2.5)	(2.4)
Impairment gains/(losses)	-	(0.3)
Bad debt recovery	0.4	0.3
Operating profit/(loss)	**2.3**	**(2.1)**
Other fair value gains	4.3	11.3
Loss on disposal of loans and advances to customers	-	(5.5)
Profit before taxation	**6.6**	**3.7**



Net interest income

Net interest income increased by £11.8m or 67% (2021: £2m or 13%) whilst loans and advances to customers grew by 32% (2021: 14%). The growth in net interest income is primarily as a result of new retail mortgage business; however, net interest income has also benefited from the disposal of the reversionary asset portfolio in April 2022 and the breaking of the associated swaps. These swaps previously eroded net interest income due to the material swap cost associated with managing the interest rate risk on this portfolio.

Financial ratios	2022	2021
Net interest income	£29.4m	£17.6m
Average total assets	£1,787.1m	£1,561.3m
Net interest margin[1]	**1.6%**	**1.1%**
Cost to income ratio[2]	88.6%	98.9%

1 Net interest margin: net interest income / average total assets

2 Cost to income ratio: administration expenses as a proportion of net operating income.

• Chief Financial Officer's Report (continued)

Net interest margin

The increase in net interest income has flowed through to an improvement in net interest margin. The Bank has benefitted from the trend in customers moving towards shorter duration deposits as there has been little incentive for customers to fix for any significant length of time due to the lower interest rate environment experienced in recent years. The Bank also benefitted from being a participant in the Bank of England's TFSME scheme.

Operating profit

The Bank's performance at an operating profit level has improved by £4.4m, primarily as a result of the growth in net interest income. The Bank has also observed growth in investment income, which represents profits on reversion sales, which is due to the strong performance of the residential property market in 2022.

Administrative expenses

Overall administrative expenses increased by £8.3m (2021: £1.6m annualised) or 32% (2021: 6%). Approximately half of the increase relates to staff costs as the Bank continued to invest in people to support the strategic plan and the Bank's digital transformation. In addition, following the disposal of Hodge Life by the Group in 2021, a higher proportion of the Group's central overheads has been retained by the Bank. Moving forward, the aim is to grow the Balance Sheet of the Bank whilst keeping the underlying cost base relatively stable.

Expected credit losses (ECL)

Total ECLs at 30 September for the retail mortgage portfolio amounted to £0.5m (2021: £0.1m). The impairment charge for the year on the retail portfolio is £0.2m, reflecting both the growth in the retail book and the uncertainty of the current economic climate.

For commercial lending, the ECL at 30 September stood at £7.1m (2021: £7.3m). The impairment credit for the year of £0.6m reflects the planned reduction in legacy commercial exposures to support the launch of new commercial lending products.The Bank also benefited from a recovery of £0.4m on a commercial exposure which was previously written off.

For portfolio buy-to-let, the ECL at 30 September stood at £1.2m (2021: £0.9m). The impairment charge of £0.4m partly reflects the growth in the portfolio and the uncertainty of the current economic climate.

Sale of reversion portfolio

The Board made the decision to sell the majority of the Bank's reversionary assets during the year to a fellow subsidiary of the Group. The disposal of this portfolio reduces the Bank's susceptibility to both house price and interest rate risk.

Other fair value gains

The growth in interest rates towards the end of the financial year has resulted in fair value gains on interest rate swaps of £8.5m, plus a hedge ineffectiveness gain of £2.5m, offset by a decrease in the fair value of reversionary assets of £5.5m and a fair value loss on the retirement mortgage portfolio of £1.2m. The higher interest rate environment results in a higher discount rate being applied to discount the future anticipated cash flows associated with these assets and liabilities

Balance Sheet overview

	2022 £m	2021 £m	% Change
Liquid assets[1]	345.7	530.2	(34.8)
Loans and advances to customers	1,404.6	1,061.5	32.3
Investment properties	9.2	94.6	(90.3)
Other assets[2]	101.3	27.1	273.8
Total assets	**1,860.8**	**1,713.4**	**8.6**
Deposits from banks	221.0	145.0	52.4
Deposits from customers	1,425.0	1,381.0	3.2
Other liabilities[3]	25.3	24.6	2.8
Pension liabilities	4.5	14.2	(68.3)
Share capital and reserves	185.0	148.6	24.5
Total equity and liabilities	**1,860.8**	**1,713.4**	**8.6**

1 Liquid assets: made up of Cash and balances held at central bank, Government bonds, Debt securities and Loans and advances to credit institutions
2 Other assets: made up of Intangible assets, Property plant and equipment, Deferred tax assets, Other assets and (2022: Derivative financial instruments)
3 Other liabilities: made up of (2021: Derivative financial instruments) and Other liabilities

Loans and advances to customers

Loans and advances to customers has grown significantly, underpinned by record gross new lending of residential mortgages of £512.4m (2021: £362.3m). The retail mortgage book has grown primarily due to increased demand for later life lending, holiday buy-to-let and traditional buy-to-let products. The growth in the retail mortgage portfolio has been partially offset by the planned reduction in a number of legacy commercial exposures.

Liquidity

The Bank holds liquid assets to meet its financial obligations in both business-as-usual and stressed situations. At 30 September, the Bank held £345.7m of liquid assets (2021: £530.2m) which are available to protect it from liquidity stresses.

Liquidity levels remained within board risk appetite and regulatory requirements throughout the year, including the Liquidity Coverage Ratio (LCR), which ensures that sufficient high-quality liquid assets are held to survive a short term severe but plausible liquidity stress. The Bank's LCR as at 30 September 2022 was above the regulatory minimum of 100% at 251.9% (2021: 349.6%), the reduction being driven by the planned decrease in liquid assets.

Funding

Retail savings remain a primary funding source, with savings balances increasing to £1,425.0m (2021: £1,381.0m). The Bank is also a participant of the Bank of England's TFSME scheme with balances increasing to £205.0m (2021:£145.0m).

Defined benefit pension scheme

In the prior year, the Bank closed its defined benefit pension scheme to further accrual and introduced a defined contribution scheme. At 30 September 2022, the defined benefit scheme had a deficit (the difference between scheme assets and scheme liabilities) of £4.5m (2021: £14.2m). The Group made deficit contributions to the scheme of £1.2m in 2022 (2021: £1.6m). The scheme also benefited from £9.0m (2021: £2.6m) of actuarial gains, primarily due to the rise in interest rates.

Capital and Leverage

The Bank holds capital to protect itself, and depositors against unexpected losses. The amount of capital required to be held is determined as part of the Bank's capital risk appetite which assesses the material risks to which the Bank is exposed, how those risks are managed and the level of capital to be held against them.

The Bank's primary measure for assessing capital adequacy is the Common Equity Tier 1 ratio (CET1). This ratio assesses the amount of the highest quality of capital as a proportion of risk weighted assets. The Bank uses standardised risk weights to calculate the risk weighted exposure. As at 30 September 2022 the Bank's CET1 ratio stood at 25.2% (2021: 20.2%). This increase is due to the parent company subscribing to £25m of share capital in June 2022 and the total comprehensive income for 2022, offset by the increased capital requirements from the growth in the Balance Sheet.

Alongside the CET1 ratio we actively monitor our Leverage Ratio. This is a capital ratio that excludes the risk weighting of assets. The Leverage Ratio at 30 September 2022 was 9.6% (2021: 8.3%). We are not captured under the Financial Policy Committee's Leverage Ratio Framework which became a binding requirement from 1 January 2022 for institutions with over £50bn of retail deposits. However, the Bank comfortably meets these requirements.

Jan Preece
Chief Financial Officer
9 December 2022

Long-term viability statement

Our Commercial Lending proposition is dependent on meeting the individual needs of our customers, tailoring our approach to accommodate their specific set of circumstances.

Hodge assessment of prospects
The resilience of our business model is relevant to any consideration of our prospects and viability. We benefit from the diversification between our specialist retail mortgages and our commercial lending businesses, which enables our services to be provided in a capital-effective way allied with our track record in attracting funding from different sources. We assess our prospects on a regular basis through our financial planning process. Our rolling five-year strategy forecasts the Bank's profitability, cash flows, capital and funding requirements and is reviewed by the Board each year.

Our business and financial planning also takes into account our obligations to depositors and the funding of our defined benefit pension scheme.

The Board believes that the market for our products will be strong for at least the next five years, this is supported by the increasing customer demand. Our commercial lending proposition is dependent on meeting the individual needs of our customers, tailoring our approach to accommodate their specific set of circumstances. The digitalisation of our savings business will assist in making Hodge less dependent on its existing customer base and our commitment to ensuring that customers can deal with us through their channel of choice means that the directors are confident that the Bank will continue to retain and attract loyal depositors. Given the long-term nature of many of the business' mortgage products, the directors have also given due regard to the possible impact of climate change on its future prospects.

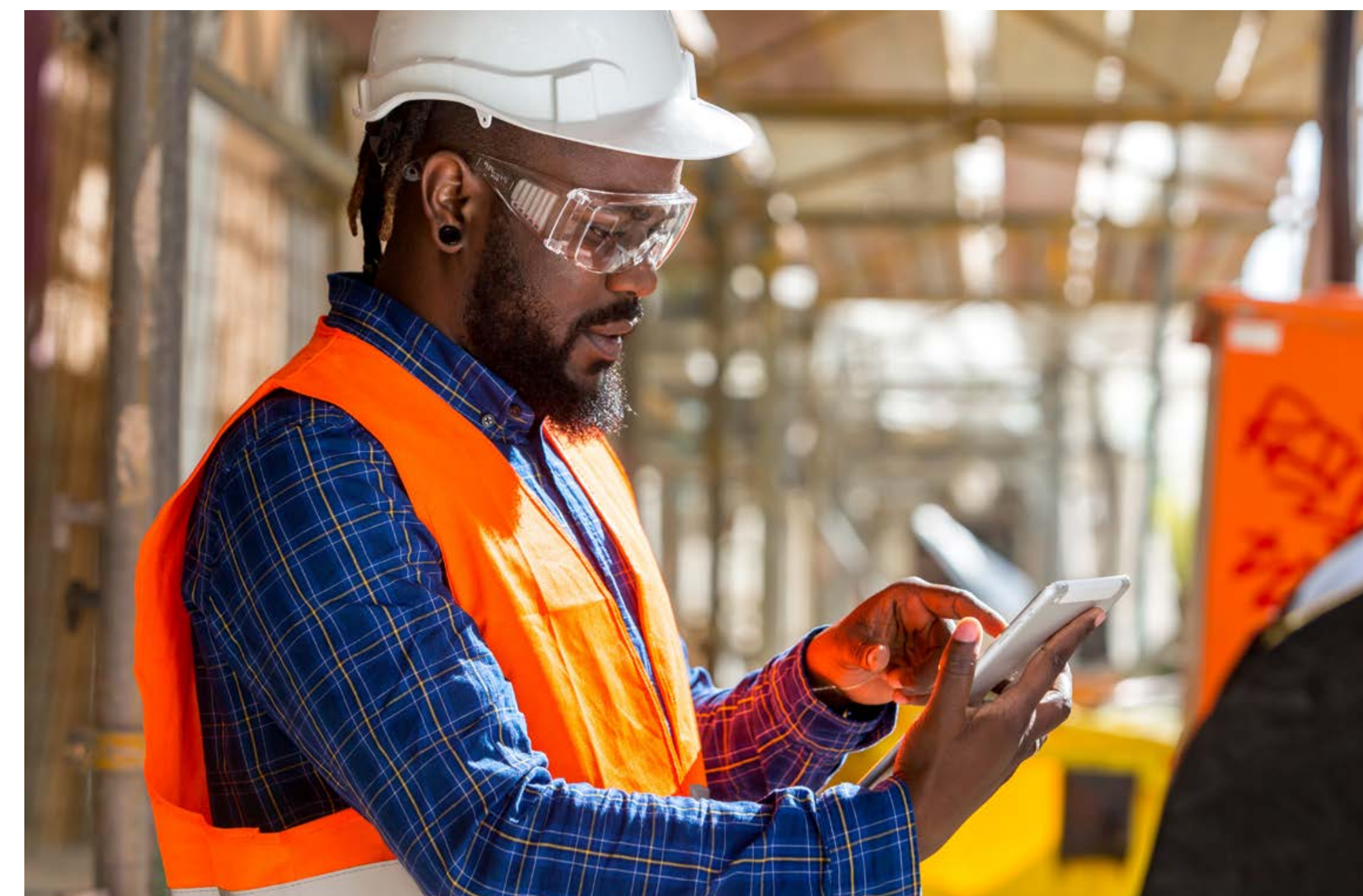
Impact of War in Ukraine & Cost of living crisis
The ongoing war in Ukraine is continuing to put pressure on household budgets as the resulting inflation is putting a squeeze on UK households' real personal disposable incomes. This is expected to continue into next year with milder declines in consumer spending and GDP. Continued squeezes on disposable income could lead to customers missing mortgage payments. At the date of signing the financial statements, there remains a range of outcomes and possibilities in relation to the war in Ukraine and its effect on future inflation.

Hodge response
The Bank continues to track political developments, and discussions on these matters are commonplace in committees and in Board meetings, particularly given the uncertainty and its impact on economic fundamentals.
The risks associated with individual topics are given considerable thought and discussion covering how they may materialise and impact the Bank's strategy, customer base, capital and liquidity.

Consideration of risks
Consideration of the risks may be summarised as follows:

- **Credit risk** – analysis of the impact on mortgage affordability and house prices caused by adverse economic conditions. The loan book has been stressed extensively over a five-year horizon against a range of macro-economic assumptions, some severely adverse;
- **IFRS 9** – Stage 1 and Stage 2 provisions have been run under a variety of economic scenarios including a 100% weighting to the negative scenario to reflect the worst-case position;
- **Capital** – credit losses and net interest income impacts have been considered including those associated with the Bank of England's publicised scenarios; and
- **Liquidity** – the risks associated with adverse impacts on liquidity have been considered.

Extensive modelling and stress testing around macroeconomic outcomes have determined that the business remains viable and able to meet its risk appetite limits and regulatory obligations.



Viability statement
The Board has carried out an assessment of the longer-term viability of the Bank. The assessment covers a period of five years, as this is the period covered by the Bank's rolling five-year strategy and regulatory and internal stress testing. The time period chosen reflects the consideration that the level of uncertainty relating to the assessment increases the longer the period chosen.

> "the Bank will be able to continue in operation and meet its liabilities as they fall due during the period to 30 September 2027.

The pace of change of the economic, market and regulatory environments in which the Bank operates may undermine the reliability of longer forecasts. The Board has based this statement on a robust assessment of those risks that could threaten the business model, future profitability, solvency, liquidity or capital adequacy of the Bank.

In making the assessment, the Board considered a range of information concerning each of its principal risks, individually and collectively, over a range of scenarios, including but not limited to, the Bank's rolling five-year plan and the programme of regulatory and internal stress testing it undertakes, further details of which are as follows:

- The plan is reviewed by the Board in detail at least annually. The plan makes certain assumptions about the performance of the Bank and the economic, market and regulatory environments in which it operates. The planning process is underpinned by a robust stress testing framework to ensure compliance with the Bank's risk appetite.
- Alternative forecasts are also constructed against a number of stress scenarios, including a robust downside scenario as part of the Board's review of the Bank's ICAAP. This involves considering a severe stress to the UK economy, with a significant fall in both residential property prices and secondary commercial real estate values and low interest rates for a sustained period and a interest rates up scenario. The results of the ICAAP are submitted to and discussed with the PRA.
- Liquidity stress tests are conducted as part of the Bank's ILAAP. The ILAAP demonstrates that the Bank holds sufficient liquid assets to meet cash outflows during a severe-but-plausible scenario where there is a combined, market-wide and firm specific stress.
- The review also considered all aspects of emerging regulation where there is sufficient clarity to inform the analysis. For example, the assessment of the Bank's capital position reflects the latest understanding of the capital buffer and leverage requirements likely to be imposed on the Bank.

Based on this assessment, the Board confirm that they have a reasonable expectation that **the Bank will be able to continue in operation and meet its liabilities as they fall due during the period to 30 September 2027**.

Graeme Hughes
Chairman
9 December 2022

2

Governance

Corporate Governance

The Board's agenda during the financial year 2022 was focused on overseeing and supporting executive management to deliver on Hodge's strategic objectives.

A comprehensive corporate governance framework is vital in supporting executive management in its execution of strategy and in driving long-term sustainable performance. It helps ensure that the Shareholder's investment in the Bank is protected, while at the same time recognising the interests of our wider stakeholders.

The Bank's approach to corporate governance is based on the Principles and Provisions of the UK Corporate Governance Code. Although the UK Corporate Governance Code is primarily aimed at listed companies, the Bank's Board is committed to operating in line with best practice standards of corporate governance. For this reason, the Board chooses to comply with the UK Corporate Governance Code in so far as is relevant to private financial services companies.

The Board's agenda during the year was focused on overseeing and supporting executive management to deliver on the Bank's strategic objectives. In periods of significant change, leadership and good governance are more important than ever.

The Board comprises of three executive and five non-executive Directors. The roles of Chairman and Chief Executive are separate to ensure that neither can exercise unfettered powers of decision-making on matters of material importance.

The Board has sought to ensure that Directors are properly briefed on issues arising at board meetings by:

- Distributing papers sufficiently in advance of meetings;
- Considering the adequacy of the information provided before making decisions; and
- Deferring decisions when Directors have concerns about the quality of information.

The Board is ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. The system of control is designed to manage rather than eliminate risks which are inherent in the Bank's business and can provide only reasonable and not absolute assurance against material misstatement or loss.

The Bank's system of internal financial control includes appropriate levels of authorisation, segregation of duties and limits for each aspect of the business. There are established procedures and information systems for regular budgeting and reporting of financial information. Financial reports are presented at every board meeting detailing the results and other performance data.

The Bank outsources its internal audit function to Deloitte. The primary purpose of this function is to review the effectiveness of controls and procedures established to manage risk. An audit programme is agreed annually in advance with the Audit Committee and the Head of Internal Audit attends each meeting to present a summary of audit reports completed during the period and to provide any explanations required by the Committee.

Governance framework

With the sale in the prior year of Hodge Life Assurance Company Limited (HLAC) to a third party by the Bank's parent, Hodge Limited, a key focus has been simplifying and strengthening the governance framework to support the ambitious growth plans of the Bank in the coming years.

COVID-19

The impact of COVID-19 continued to be a key area of focus during the year, with the Board continuously reviewing our response to the pandemic throughout our business and governance, protecting the health and well-being of our colleagues as well as maintaining the financial and operational integrity of the Bank.

The Board

The Board has ultimate responsibility for the proper stewardship of the Bank in all its undertakings. It meets regularly throughout the year to discharge its responsibilities for all important aspects of the Bank's affairs, including monitoring performance, considering major strategic issues, approving budgets and business plans and reviewing operational performance. The Board holds regular discussions with the Bank's shareholder to ensure a clear understanding of their views and requirements. A shareholder's covenant has been agreed detailing the Shareholder's expectations of the Bank.

The Chair is responsible for the leadership and operation of the Board, setting the agenda and the tone of board discussions as well as having responsibility for assessing the effectiveness of the Board and its Directors.

A board control manual has been adopted and was updated during the year which describes the high-level policy and decision-making arrangements within the Bank. The manual includes a schedule of matters reserved to the Board together with those items delegated to Directors and board and executive committees.

Details of the members of the Board are set out below.

Graeme Hughes – Chair

Graeme joined the Board in 2019 and was appointed Chair in May 2020. Graeme has spent the vast majority of his career with the Nationwide Building Society, most recently becoming its Group Distribution Director, responsible for all sales and service activities across 720 branches and 10,000 staff. Earlier roles have seen him leading group strategy and planning, as well as human resources and external affairs.

John Barbour – Non-Executive Director

John joined the Board in March 2017 and is also Chair of the Audit Committee. John was previously Managing Director of Treasury at ICBC Standard Bank, the London-based financial markets and commodities bank, owned by China-based ICBC and South African-based Standard Bank. He has spent his entire career in treasury and financial markets-related roles, having previously worked at Investec and the Bank of New York.

Aileen Wallace – Non-Executive Director

Aileen joined the Board in April 2020 and is Chair of the Innovation and Change Committee and Chair of the Remuneration Committee. She is an experienced executive turned advisor and non-executive director with more than 30 years' experience in senior financial services and digital services roles at Virgin Money (formerly CYBG Plc), Co-operative Bank, Cognizant and pre-seed Fintech. A Chartered Banker, her expertise is in business transformation, technology and customer innovation and corporate governance in highly regulated environments. Aileen is also currently a non-executive director at Target Group.

Iain Laing – Non-Executive Director

Iain joined the Board in July 2020, and is the Chair of the Board Risk Committee. He is also Chief Risk Officer of Monzo. Prior to joining Monzo, Iain had been Chief Risk Officer and a member of the executive committees of TSB Bank and Nationwide Building Society, and was Chief Credit Officer of Santander UK Retail throughout the 2007 to 2010 financial crisis.

Penny Bickerstaff – Non-Executive Director

Penny joined the Board in September 2022 and is the Senior Independent Director. She combines financial, operational and advisory experience as a former Finance Director and PwC Partner. Her background has covered professional services, retail, consumer and media, and government. She has worked closely with FTSE 100 groups as well as major UK government departments, on issues such as audit, risk, strategy, M&A, regulation, change and transformation. A Chartered Accountant, she brings board experience from the accountancy profession having served on several ICAEW boards, before joining PwC.

David Landen – Chief Executive Officer

David was appointed Chief Executive Officer (CEO) in September 2020, stepping up from Chief Financial Officer (CFO) and Deputy CEO. David joined the Group in 2002 and has held a variety of finance and treasury roles during his time with the organisation. He was appointed to the Board as CFO in 2011. An accountancy graduate from Cardiff University, he is a fellow of the Association of Chartered Certified Accountants.

Matthew Burton – Retail Director and Deputy Chief Executive Officer

Matthew joined the Board in April 2020 on his appointment as Interim CFO. He has since been appointed as Retail Director and Deputy CEO. Matthew joined the Bank in 2015 as the Group's Head of Finance, before taking up the role of Managing Director of Mortgages in February 2019. Matthew has a 14-year career in finance – having held roles at Future plc, Zodiac Aerospace and BDO LLP.

• Corporate governance (continued)

Jan Preece – Chief Financial Officer

Jan joined the Bank and was appointed CFO in September 2021. Jan has a 25-year career in finance having previously performed the Finance Director role for Friends Provident International (part of the Aviva Group) and prior to that several senior finance roles, including Finance Director within the General Insurance Business of Lloyds Banking Group.

Board Committees

The Board has established the following standing committees:

Audit Committee:

John Barbour (Chair), Helen Molyneux (to 24/3/2022), Aileen Wallace, Iain Laing and Penny Bickerstaff (from 22/9/22).

All members of the Audit Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Audit Committee is to review the work of the internal audit function, to consider the adequacy of internal control systems, to oversee the relationship with the external auditors, to review the statutory accounts including the key estimates and judgements used in the statutory accounts and to consider compliance issues.

The Committee meets at least four times a year. A report from the Chair of the Audit Committee can be found on page 23.

Board Risk Committee:

Iain Laing (Chair), Graeme Hughes, John Barbour, Helen Molyneux (to 24/3/2022), Aileen Wallace and Penny Bickerstaff (from 22/9/2022).

All members of the Board Risk Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Board Risk Committee is to oversee the management of risk and the conduct of business on behalf of the Board to ensure that significant risks are identified, understood, assessed and managed and that good customer outcomes are achieved. It is responsible for the second line of defence of the business, ensuring that the level of assurance available to the Board is sufficient and appropriate.

The Committee meets at least eight times a year. A report from the Chair of the Board Risk Committee can be found on page 25.

Nomination and Governance Committee:

Graeme Hughes (Chair), Helen Molyneux (to 24/3/2022), John Barbour, Aileen Wallace and Penny Bickerstaff (from 22/9/2022)

All members of the Nomination and Governance Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Committee is to recommend the appointment of Directors to the Board and board committees and to ensure that the Bank has an appropriate succession plan for executive and senior management positions. It also is responsible for ensuring that the Bank's Diversity and Inclusion policy is being delivered.

The Committee meets at least 4 times per year. A report from the Chair of the Nomination and Governance Committee can be found on page 27.

Remuneration Committee:

Aileen Wallace (Chair from 24/3/2022) Helen Molyneux (Chair to 24/3/2022), Graeme Hughes, Iain Laing and Penny Bickerstaff (from 22/9/2022).

All members of the Remuneration Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Remuneration Committee is to consider remuneration policy and specifically to determine the remuneration and other terms of service of executive Directors and senior managers. The executive Directors decide fees payable to non-executive Directors.

The Committee meets at least 4 times per year. A report from the Chair of the Remuneration Committee can be found on page 28.

Innovation and Change Committee:

Aileen Wallace (Chair), Helen Molyneux (to 23/3/2022), Graeme Hughes and Penny Bickerstaff (from 22/9/2022).

All members of the Innovation and Change Committee are non-executive. Executive members of the Board and other senior executives attend as required by the Chair.

The function of the Committee is to oversee the end-to-end digital delivery of the Bank's product and services. It monitors investment and management of risk associated with the delivery of change associated with the Bank's strategic initiatives.

The Committee meets at least 4 times per year. A report from the Chair of the Innovation and Change Committee can be found on page 30.

Board and Committee Membership and Attendance

Name	Board		Audit Committee		Board Risk Committee		Nomination and Governance Committee		Remuneration Committee		Innovation and Change Committee	
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
Graeme Hughes	10	10	6	6	7	7	3	3	6	6	6	6
John Barbour	10	10	6	6	7	7	3	3	-	-	-	-
Helen Molyneux*	4	4	4	4	3	3	3	3	2	2	1	1
Penny Bickerstaff**	1	1	1	1	1	1	-	-	1	1	1	1
Aileen Wallace	10	10	6	6	7	7	3	3	6	6	6	6
Iain Laing	10	10	6	6	7	7	-	-	6	6	6	6
David Landen	10	10	-	-	-	-	-	-	-	-	-	-
Matthew Burton	10	9	-	-	-	-	-	-	-	-	-	-
Jan Preece	10	10	-	-	-	-	-	-	-	-	-	-

(a) Number of meetings held at which a Director was entitled to attend (b) Number of meetings attended

Notes:

*Helen Molyneux resigned from the Board on 24 March 2022.

**Penny Bickerstaff was appointed to the Board on 22 September 2022. Prior to this date, she attended meetings as an observer

Risk Management Report

The past year has seen COVID-19 persisting across the UK but posing less of a disruption as we learn to live with it in society with the UK economy seeing a strong recovery through this period for GDP, unemployment and house prices. However, since early 2022 the Russia Ukraine conflict has continued to pose global risks particularly through the cost of energy and disruption to key food exports. The conflict has seen inflation in the UK soar with forecasts predicting more to come and in response the Bank of England are raising interest rates which when all combined is leading to a real cost of living squeeze for all areas of UK society. **The Bank is seeing resilience from its customer base** and has not seen this filter through into material increases in arrears on its loans or requests for early access to deposits but these are risks we continue to discuss and monitor regularly particularly with the economic outlook signalling more negatives than positives over the coming year; therefore the Bank remains cautious whilst seeking to fulfil its strategy.

Continued progress through the past financial year has been made in our strategic objective to **de-risk the Bank's Balance Sheet** by reallocating elements of exposures not easily mitigated through management actions to other parts of the Group where they continue to realise their value but now have more appropriate mitigations in place on the risks they pose.

The business model has a **medium to low risk profile** due to the relatively straightforward products we offer and being a financial services provider solely focused on the UK, on this backdrop the Bank sees managing risk effectively as fundamental to our strategy, long term resilience and to operating successfully day to day.

Risk Management Framework

The Bank's Risk Management Framework is an integral part of the the Bank's business model to support:

- Delivering against its strategy within an appropriate risk culture;
- Building greater resilience to organisational threats; and
- Protecting its customers from unfair outcomes.

Risk management is every colleague's responsibility at all levels and roles. The Board sets the 'tone from the top' to cascade through the business.

The Bank uses a single Risk Management Framework with which all business and support areas, including those outsourced to third party providers are managed. This ensures that a set of minimum requirements and consistency of standards and processes is used across the business.

The Bank's strategy and business model are underpinned by clearly defined risk governance, ensuring alignment with the Board's appetite for risk. The Bank operates entirely within the UK financial services market and only takes on risks, which it has the capability to understand and to manage effectively. A Risk Management Framework, supported by a three lines of defence governance model, ensures strong risk awareness, assessment, monitoring and management across all principal and emerging risks. Risks are managed within the risk appetite set by the Board and stress testing is undertaken to ensure that the capital and liquidity of the Bank would enable it to survive severe but plausible market-wide and firm specific stresses.

Through the year there have been improvements to risk management through ongoing refinement of policies, processes and procedures, and recruitment of risk resources across both first and second lines of defence, such as:

- Compliance with SS3/19 on climate change and assessment of the financial risks it poses on lending portfolios for physical and transitional risk;
- Refinement of the Financial Crime Framework and supporting standards.
- Improvements in risk reporting to ERC and BRC;
- Additional resource in first line risk areas of financial crime and quality assurance;
- IT & Change focused risk resource in second line.

Risk Culture

The Bank has a strong culture of risk awareness and control and actively monitors and manages the risks of its business, as well as emerging industry risks which may have an impact on those activities, through its Risk Management Framework.

This culture is embedded through clear expectations of roles and responsibilities and supported by defined risk appetite and risk management policies, together with effective training for all levels of staff. The Board supports **a culture of openness and transparency**, encouraging issues to be raised as identified and providing the necessary resources and support to remediate. This is underpinned by an emphasis on good customer outcomes and sustainability of the business.

An improvement in the tools to allow the business to raise issues back in 2021 has led to much more active engagement and richer data being captured through 2022.

Three Lines of Defence Model

The Bank operates a three lines of defence model which clearly sets out responsibilities for the management and oversight of risk. The Board retains ultimate responsibility for risk management. The three lines of defence model is summarised below:

First Line of Defence – Day-to-Day Risk Management

- The first line of defence has responsibility for implementation of the Bank's strategy and for the management of risk across the organisation and is comprised of executive committees, management and staff.

Second Line of Defence – Risk Oversight

- The second line of defence is responsible for providing independent oversight and challenge of activities undertaken by the first line and provides guidance on risks relevant to the strategy. This is provided through the Risk & Compliance function, which is led by the Chief Risk Officer ('CRO') who reports to the CEO and has an independent reporting line to the Chairman of the Board Risk Committee. It maintains and reports an aggregate view of risks and performance in relation to risk appetite to the Board Risk Committee. The Risk function is not customer facing and has no responsibility for business targets or performance.

Third Line of Defence – Internal Audit

- The third line of defence provides independent and objective assurance on the design and effectiveness of the Bank's governance, and activities of the first line and second line of defence. This assurance is obtained through the use of internal audit services provided by Deloitte. Internal audit reports directly to the Chair of the Audit Committee and the CEO and is independent of the first and second lines of defence.

• Risk Management (continued)

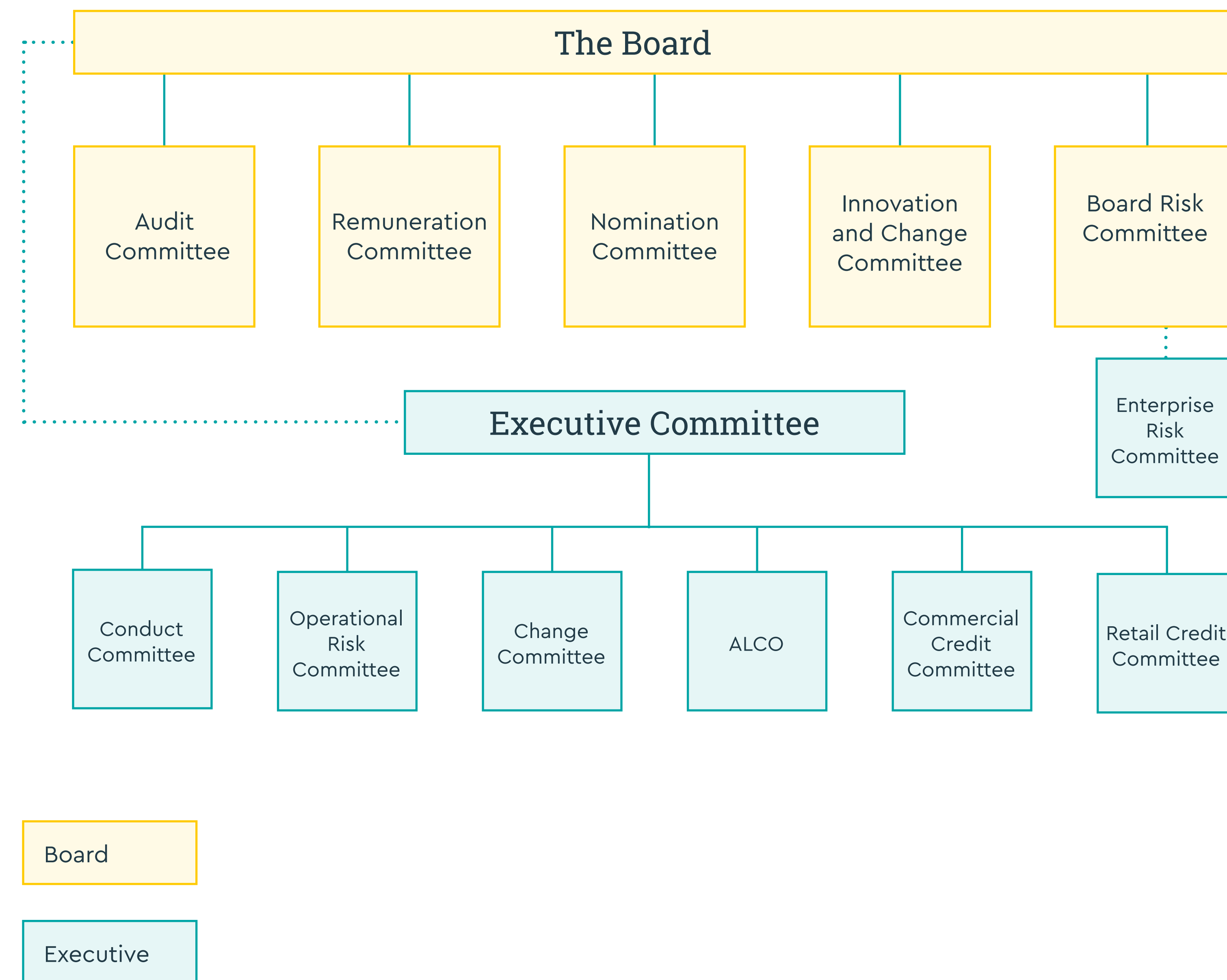
Risk Governance Structure

The Board is ultimately responsible for the overall risk governance and effective management of risk within the Bank. The Board determines the risk strategy and ensures that risk is monitored and controlled effectively.

The Board Risk Committee reviews, on behalf of the Board, the key risks inherent in the business and the control framework in place to manage such risks, reporting material findings to the Board.

There is a formal structure of Risk Management Frameworks and policies in place, setting out risk limits and triggers and minimum operating standards, which are aligned to the Board's risk appetite.

Risk governance is supported by a structure comprising of executive committees, each with escalation routes for risk matters through the Board Risk Committee and Board as shown below:



Executive Committees:

Each committee includes appropriate representation from the Executive Committee and risk specialists. The responsibilities of each of the Committees is documented in the Terms of Reference of that committee. The executive committees are aligned to the principal risk categories of the Bank and chaired as closely as possible by the respective SMF holder. Each committee has supporting working groups with a delegated mandate but accountability remains in the executive committees. A high-level summary is set out below:

Enterprise Risk Committee is chaired by the Chief Risk Officer. The Committee is responsible for oversight and monitoring of all enterprise wide risks and for the development of the Risk Management Framework.

Operational Risk Committee is chaired by the Retail Director. The Committee is responsible for the monitoring and oversight of operational risks across the business and for the development and implementation of the Operational Risk Framework and ensuring adequacy of the control environment.

Conduct Committee is chaired by the Retail Director. The Committee is responsible for the identification, management and monitoring of the conduct risk across the business and to assist in the development and implementation of the Conduct Risk Framework and ensuring adequacy of the control environment.

Change Committee is chaired by the Chief Information Officer. The purpose of the Change Committee is to ensure the Bank's Change Programme is aligned with the Bank's strategy and business plans and to monitor programme delivery, budget and resources.

Assets & Liabilities Committee (ALCO) is chaired by the Chief Financial Officer. The Committee is responsible for the management of and implementation and maintenance of policies relating to capital management, liquidity management, interest rate risk and treasury credit risk. It also delegates responsibility to the Finance Committee for review and challenge of significant accounting policies and the judgements within.

Retail Credit Risk Committee is chaired by the Retail Director. The Committee is responsible for the implementation and maintenance of Retail Credit Risk policy. The scope of the Committee covers monitoring and development of all retail lending activity.

Commercial Credit Risk Committee is chaired by the Managing Director of Commercial Lending. The Committee is responsible for the implementation and maintenance of the Commercial Credit Risk policy. It is also responsible for reviewing, challenging and if appropriate, approving credit proposals for new commercial lending deals within its delegated authority.

Risk Strategy

The Bank's Risk Strategy sets out the **risk management approach to support the achievement of its strategic ambitions**. It sets out which risks will be avoided, mitigated or accepted and is implemented by defining tolerances to the risks it faces through its risk appetite. The Risk Strategy also assesses the Bank's level of maturity against its Risk Management Framework to identify areas of improvement for the coming year.

In summary the Bank manages risks by:

- Identifying, assessing and monitoring the risks arising from the business model;
- Setting appropriate risk appetite with defined measures and limits;
- Ensuring appropriate skills and resources are present for effective management of risks;
- Identifying and tracking treatment plans for known control weaknesses; and
- Scanning the horizon for emerging risks and regulatory changes.

Risk Appetite

The Board sets a risk appetite to define the level of risk that the Bank is willing to accept or wishes to avoid in order to meet its business objectives. A risk appetite statement is in place that includes both qualitative statements and quantitative measures and addresses each of the key risk types faced by the Bank as articulated within the Risk Strategy.

The risk appetite statements are reviewed annually and linked to the Bank's strategy and supported by a suite of risk metrics, limits and triggers designed to monitor the exposure to the principal risks and together outline parameters within which the Bank operates.

The risk appetite statement is not just a static reporting tool; it provides a framework against which all strategic and operational business decision making must be assessed.

• Risk Management (continued)

Top and Emerging Risks

In addition to the principal risk categories noted below, the Bank's top and emerging risks are identified through the Bank's risk management processes.

These are specific risks within the Bank's principal risk categories that are significant to the Bank throughout its strategic plan. The key risks and details of how they are mitigated is set out below:

Current threat/Emerging risk	Mitigation/Strategic response
Macroeconomic/political environment The Bank is particularly exposed to changes in the macro economic environment predominantly due to the nature of its business through its lending portfolios. This is currently taking form through the UK's cost of living crisis and is likely to be the key driver of the uncertain and negative economic outlook for the coming year but also has the potential for elevated fraud as people come under increasing pressure to balance household incomes. A downturn in the market has the potential to filter through to increased arrears, provisions and ultimately credit losses. Additionally, there will be other factors that impact the business, but credit risk is the largest.	- Our strategy includes sensitivities for key assumptions that would reflect the impact of these downturns. - The ICAAP and ILAAP explore more extreme scenarios and sensitivities than is currently forecast in the economic outlooks which suggests the Bank can remain resilient over the period. Along with the Recovery Plan that provides our mitigating actions if required. - Monitoring of early warning indicators is in place on a regular basis along with economic commentary discussed regularly at ALCO and BRC. Portfolios are closely monitored at a business and executive level to identify any early adverse trends that will need to be reacted to. - Deep dives into lending portfolios take place through the year and presented to executive and board level committees to review any trends or issues identified. - Monitoring and management of credit policy to reflect current and future risks is ongoing through the year. - Continued monitoring of financial crime attempts.
Market/competitive environment COVID-19 was pivotal in changing customers behaviours and requirements which has, and continues to have the potential to, change their financial service requirements. Disruptive technologies, new competitors (traditional and non-traditional) and a search for yield all have the ability to threaten the current business model and achievement of the strategy.	- Continual monitoring of customer needs and the competitive environment is undertaken and discussed regularly alongside strategy development. - Competitor benchmarking and networking forums allow insight into firm's potential strategic intent. - Appropriate market research and product development governance processes are conducted to ensure strategic initiatives are properly controlled. - Strategic initiatives have been completed to simplify the business model and exit assets that can cause significant volatility to the financial results. - The strategy has been refreshed in the current year and our position in the markets assessed along with threats and opportunities to understand the flexibility and resilience of the business model.
Change & execution risk The Bank has committed to a number of strategic change initiatives which are key to the achievement of our strategic objectives. There is clear linkage to the competitive environment. To ensure our business model remains relevant it needs to evolve which requires change. These significant activities increase cost and execution risk including timelines for delivery.	- The change programme will deliver additional resilience to the Bank's business model and its operational resilience once fully implemented. - Several of the change initiatives completed in the reporting period have been focused on simplifying the business model to improve resilience. - The change programme has risk management processes in place to ensure safe and controlled delivery of the initiatives required. Retrospective reviews of change delivery are regularly carried out to continually learn from the process. - During the strategy review additional focus was put on core change initiative benefits and how they support the strategy achievement and also removing change that did not contribute.
Cyber threat The threat of cyber related attacks remains prevalent across all industries particularly as the UK continues to impose sanctions on Russia. The sophistication of the attacks continues to increase and the threat of not maintaining and improving the security of the organisation has the potential to lead to vulnerabilities. Key threats include: - compromised customer accounts; - security vulnerabilities; - ransomware attacks; and - attacks on third parties.	- The Bank continues to review, mature and invest in its cyber security control environment and compliance with the NIST framework to reflect the ever-changing nature of cyber threats. It backs up the reliance on its control environment against the impact of this risk by also holding cyber risk insurance. The cost and availability of cyber insurance in the market is posing its own threats that continue to be monitored to ensure we maintain adequate coverage. - Recruitment of additional resource in the cyber risk across first and second lines of defence to strengthen the skills and capabilities of the organisation. - Test scenarios have been conducted to assist in the identification of potential vulnerabilities with actions to remediate and address any weaknesses identified.
Climate Change risk Climate change and how society is responding to this remain a worldwide area of focus and continues to evolve in our understanding, outlook and responses. Financial risks from climate change arise through two primary channels; physical i.e. specific weather events and damage to assets and transition risks i.e. increased regulation to adjust to low carbon economy.	- ESG considerations are taking greater prominence in the strategic plan and risk agendas, particularly climate change risk and as such a fast-moving topic it is offering risks and opportunities which require consideration for achievement of both firm level and global targets on climate change. - The Bank has partnered with leading climate data providers to develop its understanding of physical and transition risks to allow measurement and assessment of its exposure to financial risks from climate change. - Compliance with SS3/19 was achieved by the end of 2021 but this will continue to develop and mature as the industry builds its capability and knowledge. - The Chief Risk Officer has been designated senior management responsibility with ensuring consideration of transitional risks (including legal and regulatory risks) arising from climate change and embedding this in the Risk Management Framework. - Climate change risk has been added to the risk taxonomy across the organisation. - The financial risks from climate change are being addressed specifically as part of the ICAAP but also the knowledge learnt is then informing strategic and business model decisions.

Pandemic risk has dropped out of the top risks for the Bank. Whilst globally disruptive from an operational perspective, not having large numbers of colleagues impacted simultaneously before the vaccination programme took effect, the Bank, like many others, coped reasonably well, adjusting quickly to new ways of working in response. However, it remains on the emerging risk register as different variations or pandemics may impact or crystalise in a different way and cause wider disruptions.

The Bank conducts on-going horizon scanning to identify new risks that could threaten achievement of the strategy and ensure they are captured in the Risk Management Framework as early as possible. The governance structure in place enables a strong awareness of current and emerging risks, which are recorded and monitored to ensure that appropriate mitigation and monitoring strategies are adopted. Mitigating actions are logged, business owners allocated, and warning indicators identified to ensure effective ongoing monitoring. Oversight of emerging risks is provided by the Board Risk Committee.

• Risk Management (continued)

Principal Risks

These are the most significant risks faced by the Bank which could impact the viability of the Bank and delivery of our strategic objectives. Risk appetite limits and triggers as well as key risk indicators are in place for each principal risk and reported to the relevant executive committee. Aggregated reporting is provided to the Board Risk Committee to support it in its duties.

CREDIT RISK – the risk that a counterparty will be unable or unwilling to meet a commitment that it has entered into with the Bank when it falls due.

Key drivers and appetite	Our approach
Credit risk emerges from commercial lending exposures, retail mortgages to retail customers and from investments held by the Treasury function. Concentration risks within and across these portfolios is also considered. The Bank is willing to be exposed to a moderate level of risk for an acceptable return.	The Bank assesses its exposure to and management of credit risk with reference to three sub-categories: **Retail credit risk** – the risk of financial loss from retail mortgages due to the customer's failure to service interest or repay capital. **Commercial credit risk** – the risk of financial loss from a commercial lending customer's failure to settle financial obligations as they fall due or movements in commercial real estate prices. **Treasury credit risk** – the risk that a debt issuer or counterparty will fail to make payments (either interest or principal) in a timely manner or the credit worthiness of counterparties deteriorate reducing the value of investments. Within each business line there is dedicated first line risk management provided by appropriately skilled credit managers and treasury staff. Pricing of lending products includes a component of margin to cover expected credit losses. Treasury counterparties are restricted to a number of well-established and externally rated institutions. The following mitigation practices are in operation: - Approved underwriting policies and authorisation mandates are in place for each sub-category in order to direct lending decisions, ensuring that the Bank lends responsibly while taking an acceptable level of credit risk. - Rating and scoring systems in place and controls to support lending decisions with the addition of affordability stress tests. - Limitations on concentration risk across portfolios are implemented via risk appetite limits on large exposures, geographical and sectoral exposures, and loan to income ratios. - Appropriately skilled colleagues are employed by the Bank to monitor and manage credit risk within the defined parameters set by the Board. - Portfolio level stress testing and scenario analysis.

FINANCIAL RESILIENCE RISK – the risk that the Bank fails to maintain or protect its capital and liquidity resources to meet regulatory requirements, absorb volatility and losses through economic cycles and changes in market rates, and to maintain the confidence of customers, investors and regulators.

Key drivers and appetite	Our approach
Financial resilience risk arises from changes to the respective resources (i.e. capital and liquidity) and risk profiles of the Balance Sheet driven by customer behaviour or management decisions. It also arises from the external environment, including changes to market metrics such as interest rates or property prices together with changes to the regulatory regime. The Bank aims to mitigate financial resilience risk where possible and commercially viable to do so and any residual risks have financial resources allocated to support them.	The Bank assesses its exposure to and management of financial resilience risk with reference to the following sub-categories: **Capital risk** - The risk that the Bank fails to maintain sufficient capital to meet regulatory requirements, absorb volatility and losses through economic cycles, and to maintain the confidence of customers, investors and regulators. **Liquidity risk** – The risk that the Bank is unable to meet its financial obligations as they fall due or unable to maintain customer and stakeholder confidence or can only do so at an uneconomic cost. **Interest rate risk** - The risk of loss in the value of, or net income arising from, assets and liabilities due to changes in the market level of interest rates. **Market risk** – The risk that the net value of, or net income arising from, assets and liabilities is impacted because of market price or rate changes. Treasury and Finance provide strong first line risk management expertise and have day to day responsibility for the management of financial resilience risk within defined board policies and limits. The following mitigation techniques are in operation: - Frequent monitoring and reporting of exposures, portfolio composition and changes and forecasts of key ratios; - Reporting of regulatory key metrics across capital, liquidity and interest rate risk; - Stress tests run to ensure the Bank maintains adequate levels of capital and liquidity for business purposes even under stress; - Well defined board policies and limits, monitored regularly; - Extensive contingency and recovery plans in place; - Key regulatory assessment documents embedded for ICAAP, ILAAP and Recovery Plan; - Maintenance of high-quality capital surplus; - Maintenance of a liquidity buffer of high-quality liquid assets; - Well matched maturity profile of assets and liabilities; - Composition, credit quality and maturity profile of liquidity portfolio and funding balances in line with agreed policies; - The interest rate structure of assets is matched with liabilities to create a natural hedge and supported by derivatives where appropriate; - Various interest rate stress tests are applied to the portfolio to help identify any potential weaknesses that require further remediation.

STRATEGIC RISK – the risk of significant loss or damage arising from business decisions made in setting and executing the Bank's strategic plan, and/or from an inability to adapt to external developments.

Key drivers and appetite	Our approach
Strategic risk can arise from changes to the business model and also the risk of the business model or strategy proving inappropriate due to macroeconomic, political, regulatory or other impacts. The risk to delivery of the strategy is deemed to be the principal risk. At present this category includes the risks from climate change due to its impact across all risk categories and to keep it visible whilst we mature our risk management in this field.	Close management and monitoring of the strategic plan along with in-depth stress testing reported regularly through the Bank's committee structure to the Board and senior management. This is supported through additional risk reporting and monitoring of the key threats to the business on risk registers and horizon scanning to ensure the business can respond appropriately. Along with competitor analysis and economic setting commentary.

• Risk Management (continued)

CONDUCT RISK – the risk that the Bank's behaviour will result in poor/unfair outcomes for customers

Key drivers and appetite	Our approach
Conduct risk is inherent in any business that provides products or services to customers. Failing to treat customers fairly and deliver good outcomes would have a detrimental impact on the success and sustainability of the Bank. The Bank assesses its exposure to and management of conduct risk with reference to four sub-categories: Product design, Distribution and sales, Product servicing and Culture and governance.	- **Product design** – a product governance policy is in place to ensure that all new products are subject to an appropriate level of scrutiny and that existing products are subject to regular review to identify any risk of poor customer outcome. The Product Committee oversees the new product launches and annual product reviews to ensure products remain suitable for their respective target markets. - **Distribution and sales** – all customer lending products are distributed via independent brokers to ensure that customers receive independent advice. Deposits and commercial lending products are offered on an execution-only basis. Approval processes are in place to ensure that product literature is clear, fair and not misleading and complies with relevant regulation and legislation. Oversight on distribution and sales is provided by the Conduct Committee. - **Product servicing** – performance against service levels is monitored and customer feedback used to determine whether good outcomes are achieved. Internal quality assurance is undertaken. All complaints are thoroughly investigated and responded to promptly. Monitoring is in place to identify and quickly address any trends or systemic issues. - **Culture and governance** – reward strategies and incentives are not based on sales targets and mandatory conduct risk and customer outcomes training is in place for all new and existing employees.

OPERATIONAL RISK – the risk of loss from control failures or external events, which result in unexpected or indirect loss to the Bank.

Key drivers and appetite	Our approach
The Bank accepts that operational risks arising from its people, processes, systems or the external environment are a natural consequence of its business operations but seeks to avoid or mitigate the risk to a minor level wherever practical. The Bank assesses its exposure to and management of operational risk with reference to nine core sub-categories: - **Process** – losses from failed transaction processing or process management. - **Data & information management** – losses due to material errors in reporting or modelling. - **Financial crime & fraud** – losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or the Bank's policy. - **People** – failure to manage the human resources of the Bank in order to maximise its value. - **Legal & regulatory** – failure to comply with legal and regulatory requirements. - **Infrastructure & security** – losses or damage arising from technology through inadequate design or failure of security and resilience controls. - **Change** – failure to successfully deliver change to achieve defined strategic benefits or failure to operate robust change implementation controls resulting in disruption to operational processes and/or the customer journey. - **Third party** – services provided by third parties fail to meet required standards leading to disruption to operational processes, customer impact and/or financial loss. - **Operational Resilience** – significant business disruption affecting our ability to deliver on our responsibilities to customers and stakeholders.	Operational policies and procedures, supported by staff training, are in place to govern the way in which these risks are managed across the business. Senior management are responsible for understanding the nature and magnitude of risks within each business area, and for implementing appropriate controls to mitigate those risks. Operational losses and near-misses are recorded and analysed to determine whether there are any systemic issues that need to be addressed by the business. Horizon scanning is conducted to identify emerging regulatory and legal developments to ensure that the business can respond appropriately. This is supported by a Horizon scanning working group with representatives from across the business. Oversight on operational risk is provided by committees and governance forums. The Board is mindful that, as the digital capability of the Bank increases, the risk associated with cyber-attacks also increases. As such, particular focus continued to be given to this area throughout the year to ensure a robust cyber response.

Stress Testing and Planning

Stress testing and scenario analysis is a key tool of the Risk Management Framework which assess vulnerabilities under hypothetical or historical scenarios. The results of the stress testing identify the impact of risks that could threaten the business model, future profitability, solvency, liquidity or capital adequacy of the Bank. The Board and senior management have engaged in a number of exercises which have considered and developed stress-test scenarios covering a range of company-wide, multi-risk category stress tests, generic and idiosyncratic financial shocks, and operational and conduct risk scenario analysis in addition to the scenarios prescribed by the regulator.

Stress testing is central to the annual business planning process and to the annual review and ongoing development of the Bank's risk appetite. It is also core to the adequacy assessment processes for liquidity and capital and for assessing and improving management of the Bank's risk profile. The assessment processes for capital and liquidity are articulated through the Bank's ICAAP and ILAAP. These activities and associated documents are updated at least annually or following any significant change in the business model or risk profile.

- The ICAAP evaluates the level and quality of capital required by the Bank as defined by the Capital Requirements Directives and Regulations to ensure it adequately covers all current and future risks in the business over the medium term. In addition to the assessment these risks may pose to capital, consideration is given to the contingency actions available to the Board to mitigate those risks.
- The purpose of the ILAAP is to consider the Bank's liquidity risk management processes, an element of which is evaluating liquidity positions and requirements in both business-as-usual and stress situations. The ILAAP demonstrates that sufficient liquid assets are held to meet cash outflows during a severe but plausible scenario where there is a combined market-wide and firm-specific stress, resulting in, among other things, a significant outflow of savings accounts. The document also outlines the contingency funding arrangements available for use in a stress.

• Risk Management (continued)

Reverse Stress Testing

The Bank also undertakes reverse stress testing which is used to explore potential vulnerabilities of the Bank's strategies and plans to extreme events that could cause the business to fail. The reverse stress tests push the severity of the stress scenario to the point at which the firm's business model becomes unviable. These exercises are designed to assess the resilience of the business to adverse competitive, economic or financial developments and ensure that robust, forward-looking capital and liquidity management processes are in place to deal with the identified risks.

The reverse stress tests complement the ICAAP and ILAAP and assist management in understanding the full continuum of the levels of stress which the business can tolerate within its current resources and risk appetite. Any plausible scenarios identified with unacceptably high risks will lead the Bank to adopt measures to prevent or mitigate those risks through a change in strategy, increased controls and early warning indicators or contingency plans.

Recovery Planning

The Bank maintains recovery plans that can be enacted in the event of internal or external triggers which threaten the liquidity or capital position of the Bank. These plans are prepared in accordance with the Bank's Recovery and Resolution Directive allowing a common approach to be taken.

The Recovery Plan describes the strategy and a 'menu of actions' that could be taken by management to allow the recovery of the Bank from a significant adverse event which would otherwise lead to failure. The Recovery Plan is informed by the outcomes of the Stress and Scenario Testing Framework which the Board and senior management use to determine the strategy and actions to support a potential recovery.

The Recovery plan outlines the processes and procedures that should be followed, along with assessing the management actions to recover from a severe but plausible financial risk event. The plan tests the early warning and invocation triggers to ensure the Bank has enough time to react and put in place recovery or mitigation actions. It has close ties to the overall business continuity plan. It is reviewed at least annually or more frequent if a material change of strategy or business model suggests. A 'fire drill' for the recovery plan was conducted in 2022 which is a desktop simulated exercise to assess the adequacy of the recovery plan. The findings from this test were broadly positive with only minor improvements identified which are being built into the next iteration of the Recovery Plan.

The Resolution Plan provides data required by the PRA to be used to facilitate a rapid and orderly resolution in the event that the recovery of the Bank could not be achieved whilst maintaining any critical functions provided by the Bank to the economy.

Operational Resilience

The regulatory direction provided on operational resilience through discussion and consultation papers has led the Bank to strengthen its previous approach to business continuity by assessing the firm's critical services and the supporting processes to identify potential disruptions that could crystallise under various operational scenarios i.e. cyber-attacks or head office unavailability. These detailed assessments have allowed a much greater understanding of where to devote resources to provide effective resilience for these critical services.

A programme of work is underway through 2022 to review the maturity level of operational resilience approach and provide some external benchmarking to allow us to continue to develop and improve our approaches.

Operational resilience coupled with the financial resilience assessed through the recovery planning outlined above combines to provide a firmwide resilience framework that approaches and tests resilience of the Bank from multiple viewpoints and scenarios.

War in Ukraine

The conflict in Ukraine started in February 2022. As the Company's activities are undertaken in the United Kingdom, it is not directly impacted by this conflict; however, it has an inevitable impact on global financial markets, domestic inflation and interest rates and consequently could impact future business volumes or the ability of the Bank's customers to meet their contractual payments. The Directors will continue to monitor the situation and act accordingly, including compliance with any UK relevant legislation or sanctions.

Climate Statement

Climate Change Risk Management

During 2021 progress was made in developing and embedding the Bank's approach to climate change risk management. This included alignment and integration with the existing enterprise-wide risk management framework. To support and kick off this process a Climate Risk policy was put in place to outline scope, roles & responsibilities, governance, and alignment to Risk Management Framework.

The Bank is exposed to the following climate change related risks:

Physical risk – Specific weather events and longer-term shifts in the climate. Examples include increasing extreme weather events leading to physical damage to the value of property and longer-term declines to property prices near floodplains. These risks could result in financial losses related to the Bank's own assets and collateral used in the Bank's lending portfolios.

Transition risk – The risks associated with adjustment towards a low-carbon economy. This can be influenced through developments in policy and regulation, the emergence of disruptive technology or business models, and shifting sentiment and societal preferences which can impact the risk or value of financial assets. These changes could result in a reassessment of asset values and increased credit exposures from other banks and lenders as the costs and opportunities arising from climate change become apparent.

The Bank is also cognisant of the conduct and reputational risk arising from a failure to meet changing and more demanding societal, investor and regulatory expectations and the impacts on customer outcomes from changing behaviours in response to climate change.

Approach to analysing climate risk

The Risk function engaged with a third party to provide detailed climate change assessments at a collateral level for the Bank's loan portfolios. The data was used to undertake financial risk assessments that have been used to both inform the Board of the climate change exposure from the Bank's portfolio and to support the ICAAP assessment.

I. Climate scenarios considered

An industry standard for assessing climate change risk is the global greenhouse gas concentration. There are several scenarios to project this metric as defined by Representative Concentration Pathways (RCP) levels. The Bank has selected three different pathways to support its assessment. The Bank believes the three chosen align closely to the CBES scenarios allowing us to leverage these industry releases to support our scenario development.

The three RCPs used are:

Emissions Scenario	
RCP Scenario	Change in temperature (°C) by 2100
RCP 2.6	1.6 (0.9 – 2.3)
RCP 6.0	2.8 (1.7 – 3.2)
RCP 8.5	4.3 (3.2 – 5.4)

Note: The scenarios have an average pathway but with a range around them which is represented in the brackets in the table above.

The most severe RCP 8.5 assumes there will be no concerted effort at a global level to reduce greenhouse gases emissions. Under this scenario the predicted risk in global temperature rises is 3.2 – 5.4 ° C by 2100.

The least severe scenario RCP 2.6 assumes early action is taken to limit greenhouse gas emissions. Under this scenario, the predicted increase in global temperature is 0.9 – 2.3 ° C by 2100.

II. Climate risk events considered

The following three physical events of climate change were assessed:

- **Flood:** higher levels of average rainfall and increased severity of weather events such as storms, will increase flooding.
- **Subsidence:** changes in average temperatures and increased severity of weather events such as heatwaves will increase potential subsidence via changes to ground conditions around property foundations.
- **Coastal erosion:** increased storm events and rising sea levels will increase the rate of erosion.

For each of the physical risks and climate scenarios detailed, a prediction of today, 2030 and 2060 on the likelihood of each was provided.

For the flood and subsidence, the likelihood took the form of a risk score of the probability that a flood or subsidence event would occur in the period. For coastal erosion the future date at which the property becomes at high risk from coastal erosion was provided. These assessments took place at property address level to identify the different exposures to climate risk that even properties close to each other show.

III. Climate Transition Risks

To assess transition risks associated with properties the current Energy Performance Certificates (EPC) of each property were considered. The transition risk is the expectation of properties being required to improve to a certain level and the associated cost of achieving this or impact on value if not. For our assessment a C rating or higher is the scenario for future expectations. EPC's are not mandatory for all properties and therefore they were only available for 50% of the Bank's properties during the 2021 assessment. Accordingly, some high-level assumptions were made to proxy for the total portfolio.

Currently the Bank only has EPC ratings for 50% of the portfolio. For the 50% with an EPC the profile of the Bank for 2022 follows a similar trend to national average. The Bank has 16% of properties at EPC of C or better, 20% with EPC of D and 14% of EPC E or lower. Of the 50% of properties with EPCs, 89% have the potential to achieve at least an EPC rating of C.

IV. Assessment Methodology

For the physical risks, current valuations are adjusted to reflect the impact of each of the climate change events. These reduced valuations directly impact loan to values ratios (LTVs) and therefore the potential loss given default (LGD).

For transitional risks, the Bank's expectation is that the government will require all properties to achieve an EPC of C where possible. The cost of renovations for those properties below a C moving to a C or their highest potential was assessed utilising guidance and assumptions from the CBES scenario. If the property has an EPC of C or better, then the potential transition risk is assumed to be zero as it already meets the expectation. The impact on valuations was also assessed using some public reports on expected differences of like for like properties with different EPC ratings.

V. Assessment Outcomes

Flood risk - By 2030, the percentage of properties (based on volume) predicted to experience a high, very high or extreme risk of flood is expected to increase from 6% in the least severe scenario to 7% in the most severe but average LTVs are sub 40%. Both scenarios represent a low exposure for the Bank's loan portfolio.

Subsidence risk - By 2030 the percentage of properties with a high subsidence risk score is expected to be 2% in the most severe scenario. Average LTVs are circa 30% for this cohort.

Coastal Erosion risk- Under the most severe scenario less than 0.5% of the portfolio (£2.4m mortgage exposure) result in a high probability of being impacted by coastal erosion in the next 50 years. The average LTVs of these are low circa 45%, however, this risk presents differently as the property and land is lost to the sea so cannot be rebuilt resulting in full loss of security.

Transitional risk – The transitional costs of home improvements required to improved EPC rating are not unreasonable especially if spread over a period of 5 to 10 years. These are unlikely in themselves to impact affordability levels materially. Particularly viewed against rising energy prices the breakeven point lowers for home renovations to reduce emissions and therefore save on energy costs. Additionally, the valuation adjustments for properties with EPC rating of C or lower given our current portfolios low average LTV does not result in a material exposure.

VI. Outcome analysis

Based on the Bank's current approach and capability the exposure to financial risk from climate change is not material based on the LTV profile and EPC profile of the portfolio. As the Bank continues to mature and learn more, this assessment will be revised.

VII. Planned enhancements during 2023

The industry continues to evolve and mature with its understanding of climate risks and capabilities to assess them. The Bank will continue to engage with regulators, networks, and peer groups to help shape and learn from best practices.

During 2023 key areas of enhancement include:

- Further embedding climate risk into the risk management framework;
- Refinement of climate risk appetite statements and limits;
- Further enhancements to climate risk assessment methodologies; and
- Embedding climate risk into the risk and control self-assessment (RCSA) process.

VIII. Conclusion

The Bank considers its present financial exposure to climate-related risks to be immaterial and accordingly the disclosures made within the annual report and financial statements have been prepared on a proportionate basis.

Report by John Barbour

Chair of the Audit Committee

The Audit Committee's agenda continues to include its responsibilities as the third line of defence in Hodge's Risk Management Framework.

Another year of unexpected and dramatic change in global and local circumstances. 2021, and into 2022, saw the UK learning to live with COVID-19, with welcome respite when all COVID-19 related controls were dropped in the Spring of 2022. Such easing of controls was reflected globally, albeit not uniformly. The lifting of restrictions lead to a blossoming of suppressed demand across industries which rapidly revealed the damage to supply chains and production capacity inflicted by COVID-19 and the associated lock-downs. The first signs of inflation in years started to appear. Everyone argued these were temporary effects and Central Banks agreed, leaving interest rates at historic low levels. Then, to the disbelief of most, Russia invaded Ukraine, the world imposed sanctions on Russia and energy prices started to sky-rocket. The inflation genie was out of the bottle and belatedly Central Banks started to hike rates which, in an attempt to catch up with inflation, has been dramatic. The rise in the cost of living plus the increase in interest rates has meant that the risks of recession are high, with the associated risks that brings to bank asset quality. To add to the uncertainty, the UK saw the fall of a Prime Minister and an unprecedented event of two party leadership races in two months, ultimately returning Rishi Sunak as the new Prime Minister.

Although the financial year ended 30 September 2022 saw lifting of COVID-19 restrictions, the majority of Audit Committee meetings have been remote or hybrid, with some attendees managing to make it to One Central Square.

The Bank has continued to simplify its Balance Sheet following the sale in the prior year of its Equity Release Mortgage portfolio, and sale of its Reversion portfolio to Hodge Reversions Limited in the current year. With Julian Hodge Bank Limited remaining the primary operating Company within the Hodge Group the Board continues to approve that the primary published financials are those of the Bank.

Once again there have been a number of changes to the composition of the Audit Committee. I would like to give my sincerest thanks to Helen Molyneux who has retired after a number of years at the Bank. Helen has been a great support to me since I joined the Hodge Board and the Members of the Audit Committee wish her all the best for the future. I also welcome Aileen Wallace and Penny Bickerstaff to the Audit Committee and look forward to working with them in the future.

The Audit Committee's agenda continues to include its responsibilities as the third line of defence in the Bank's Risk Management Framework; oversight of the performance and effectiveness of internal and external audit; ensuring the integrity of the financial statements of all companies within the Group; and oversight of the Bank's system of internal control.

> "The Bank has continued to simplify its Balance Sheet following the sale in the prior year of its Equity Release Mortgage portfolio, and sale of its Reversion portfolio to Hodge Reversions Limited.

Financial and regulatory reporting

Following the sale of Hodge Life in 2021, the focus of the Audit Committee for financial and regulatory reporting shifts to the Bank. The Committee's main responsibility in relation to the Bank's financial statements is debating and challenging the judgements made by management and questioning the assumptions and estimates on which they are based. The exercise of appropriate judgement in preparing the financial statements is critical to ensure that the Bank's financial statements are fair, balanced and understandable. It should be noted that the sale of the Reversions portfolio was to Hodge Reversions Limited and therefore the valuation assumptions relevant for the Reversions portfolio were also covered in the Committee.

The following are the significant judgements, issues and actions taken by the Committee in relation to the annual report and financial statements. Each of these matters was discussed with EY during the year.

IFRS 9 impairment

Area of focus

The Committee reviewed and challenged the approach to calculating ECL provisions, including the impact from the declining macroeconomic environment.

Role of the Audit Committee

The Audit Committee reviewed IFRS 9 provision papers throughout the year. The Committee considered the recommendations made by the CFO and challenged the proposed weightings for the positive, neutral and negative scenarios which underpin the IFRS 9 modelling of expected credit losses.

The Committee received and challenged the post model adjustment presented by management to take account of the lag in the macroeconomic environment filtering through to a higher customer probability of default.

Conclusion/action taken

The Committee challenged the weightings for the economic scenarios and agreed with the weightings proposed by management.

The Committee challenged the post model adjustment and agreed that the adjustment was appropriate in the current economic climate.

Retirement Mortgages and Reversions – Accounting Methodology and Valuation

Area of focus

Notwithstanding the sale of Hodge Life, the Bank continues to hold Retirement Mortgages and a small portfolio of reversionary assets. Challenging the valuation assumptions for these asset classes remains a core responsibility of the Committee.

Actuarial services

With the sale of HLAC and its in-house expertise, actuarial expertise required for the valuation of retirement assets is provided by Milliman.

Role of the Audit Committee

The Committee reviewed a detailed assumptions paper prepared by Milliman in which assumptions from 2021 were proposed to remain unchanged except for expenses. The Committee challenged the unchanged assumptions, specifically with respect to the difference in discount curves used between Reversions and Retirement Mortgages, the difference in sales delay between the two asset types, and the continued appropriateness of using the CMI 2018 mortality tables given the impacts of COVID-19. The proposal for a change to expenses was also debated.

Conclusion/action taken

The Committee approved the unchanged assumptions as well as the proposed change to the expense assumptions.

Valuation of Derivatives

Area of focus

The Bank has a substantial amount of derivative financial instruments relative to its balance sheet size. These hedge the risk to changes in interest rates and yield curves. These derivatives are valued at fair value as at the Balance Sheet date.

The majority of interest rate derivatives are accounted for under IAS 39 hedge accounting rules. Significant changes in rates can affect their effectiveness as a hedge, which might lead to income volatility or a different accounting treatment.

Role of the Audit Committee

The Committee obtained confirmation from management that the valuation of derivatives at the year-end are in accordance with the amounts recognised by the relevant counterparties and that the hedge effectiveness calculations had been carried out appropriately.

Management were also able to evidence, for all the derivatives settled in the year, that the value attributed by counterparties prior to breaking the derivative was in line with the valuation held by the Bank.

Conclusion/action taken

The Committee was satisfied that the fair value of the derivatives was appropriately reflected in the financial statements and that, where hedge accounting was applied, it was effective.

• Report by John Barbour (continued)

Long-Term Viability Statement

Area of focus

The Directors make a statement in the Annual Report as to the long-term viability of the Bank. The Committee provides advice to the Board on the form and content of the statement, including the underlying assumptions. Once again, the Committee needed to consider the uncertainties associated with COVID-19 as part of its deliberations.

Role of the Audit Committee

The Committee reviews the Board's assessment of long-term viability through consideration of the Bank's rolling five-year strategy, the Bank's assessment of capital (ICAAP) and the Bank's assessment of liquidity (ILAAP). In addition, the Committee specifically considered the impact of changes in interest rates, affordability and economic risk on the potential for elevated loan losses and the associated impact on capital. The Committee also considered the outcome of an independent review of the Bank's five-year strategy.

Conclusion/Action taken

The Committee agreed to recommend the long-term viability statement to the Board.

Fair, Balanced and Understandable Reporting

Area of focus

The Bank endeavours to ensure that its external reporting is fair, balanced and understandable. The Committee undertakes an assessment on behalf of the Board in order to provide the Board with assurance that it can make the statement recommended by the Financial Reporting Council's Corporate Governance Code.

Role of the Audit Committee

The Committee assessed, via discussion with, and challenge of, management (including the CEO and CFO), as to whether disclosures in the Bank's published financial statements were fair, balanced and understandable.

Conclusion/action taken

Having evaluated all the available information and the assurances provided by management, the Committee concluded and were able to recommend to the Board that the Bank's published report and financial statements were fair, balanced and understandable.

External Audit

External Audit continues to be carried out by EY, with a new Partner, Robin Enstone, stepping into the shoes of Andy Blackmore. A formal review of the effectiveness and audit quality of EY was carried out in 2022 following closure of the 2021 accounts, including an assessment of the professional scepticism and objectivity of the EY team. The Committee is responsible for assessing the objectivity and independence of EY. This responsibility was discharged through the Audit Committee meetings and during private meetings with EY.

The Committee has a policy whereby all services provided which are not covered in the audit are approved by the Committee. The Bank continues to examine non-audit fees in light of the Ethical Standard issued by the Financial Reporting Council (FRC). The payments made to EY for non-audit fees in the year ended 30 September was £30,000 (2021: nil). This reflects a non-audit fee to audit fee ratio of 7.1%, the average for the last three financial years is 2.4%. The average non-audit fee for the last three financial years is below the 70% limit set by the FRC.

Internal Audit

Deloitte continues in its role as Internal Auditor and continues to demonstrate good engagement with management, executive, Audit Committee and the Board.

The Committee scrutinises and agrees Internal Audit's plans, including agreeing the areas of focus, which this year included Responsible Lending, IT Disaster Recovery and IT User Access rights, Pricing, and at the specific request from PRA (as part of an industry-wide thematic review) Deloitte carried out a review of Change and Outsourcing.

The Committee tracks the implementation of the recommendations of Internal Audit, in conjunction with Deloitte, and is satisfied that these are being implemented on a timely basis.

A review of the effectiveness of the Internal Audit function was carried out by the Audit Committee. The enhanced presence at committees of Deloitte representatives, especially that of the responsible partner, was a noted benefit. Some small recommendations for improvements were made. The findings were discussed with Deloitte in a private meeting.

Internal Control

The Audit Committee has responsibility on behalf of the Board for the Bank's systems of internal control. The Audit Committee discharges this responsibility by discussing and challenging reports issued by Internal Audit. Further, through my membership of the Board Risk Committee, I am made aware of any issues raised by the second line of defence assurance team which monitors the implementation of its and Internal Audit's recommendations. Collectively these reports provide assurance that there are effective internal controls within the Bank.

The Audit Committee also discusses any control observations raised by EY. The Audit Committee continues to encourage management to reduce the volume of manual internal controls and automate as many controls as possible to reduce operational risk.

Whistleblowing

I am the Whistleblowing Champion for the Bank and have reviewed the integrity, independence and effectiveness of the Bank's whistleblowing policies and procedures and also those policies and procedures intended to protect whistle-blowers from being victimised. The need for enhanced training with regard to both Whistleblowing and "speaking out" mentioned in my report last year has now been implemented and I am satisfied that current policies and processes are adequate.

Committee Composition and Meetings

The Committee's membership is designed to provide the depth of financial expertise and commercial acumen it needs to fulfil its responsibilities. The need for accounting expertise on the Committee has been satisfied with the appointment of the new SID, Penny Bickerstaff, as a member of the Audit Committee.

Committee meetings were attended by the CEO, CFO, CRO, Head of Compliance, representatives of Deloitte and EY, and by other members of the business, as appropriate.

During the year private meetings were held with the Lead Audit Partner from EY, as well as the Head of Internal Audit from Deloitte, without management present.

Interaction with Regulators

As Chair of the Audit Committee I meet with the members of the Bank's Regulatory team at the PRA, without management present, during their annual visit to the Bank.

Committee Performance

The Committee updated its self-assessment of its performance and concluded that the changes from previous assessments had now been appropriately implemented. One of the issues outstanding was training for members of the Committee. This is now being addressed through individual plans agreed with the Chairman of the Board.

Looking Ahead

In a year of fires, floods and record-breaking temperatures around the world the impacts of climate change become increasingly apparent. The Bank continues to develop its response to climate change. We continue to work on becoming more efficient in the amount of energy we consume as a business, increasing the effectiveness of recycling programmes and improving colleague awareness of environmentally responsible behaviour such as reducing paper, energy and personal car use. Please see the s172 Statement where the Bank has published information to comply with the Streamlined Energy & Carbon Reporting (SECR) initiative.

John Barbour
Chairman of the Audit Committee
9 December 2022

Report by Iain Laing

Chair of the Board Risk Committee

We have reviewed management's progress in meeting regulatory expectations in respect to the management of climate change, operational resilience and outsourcing.

Committee role and responsibility

The Board Risk Committee is a sub-committee of the Board and has delegated authority to assist the Board in fulfilling its oversight responsibilities for risk management.

The Committee is responsible for:

- Promoting an appropriate risk culture and overseeing the development and implementation of the Enterprise Risk Management Framework (ERMF) and associated policies;
- Monitoring our current and emerging risk profile and ensure that these are appropriately mitigated;
- Reviewing and recommending risk appetite to the Board and monitoring our risk profile within this appetite; and
- Reviewing and recommending to the Board key prudential documents (ILAAP, ICAAP and the Recovery Plan).

Committee Membership

I have been the Chair of the Board Risk Committee throughout the financial year. The Committee comprises five independent non-executive Directors with regular attendance from the CEO, CFO, CRO and the Retail Director and supported as required by other colleagues from across the business to assist in discussions. The Committee met seven times through the financial year.

The prescribed responsibilities as Chair of the Board Risk Committee are to safeguard the independence of, and oversee the performance of, both the Risk and Compliance functions. Throughout the year there have been regular meetings with the Chief Risk Officer, supported by his team, to ensure these functions are as effective as possible and enable them to air any issues or views.

Interaction with management

The Committee is mindful of the need to hold management directly accountable when issues have arisen and been reported by the CRO, Head of Compliance or other parties. Members of senior management attend committee meetings for deeper discussions of matters in their area of responsibility. During the year the Committee has followed up on potential areas of concern raised by the CRO and, separately, the CFO. With the support of the risk function, potential risks and issues have been validated, appropriate actions identified, and completion of these actions is being tracked.

The Chair meets with the CRO once or twice a month to ensure close coordination of efforts and early identification of any issues, and this is supported by occasional workshops or meetings with management on areas of particular interest to the Committee.

The review of the Bank's strategy has been a key area of focus for the Board in the financial year, and the Board Risk Committee has supported this with a focused review of risks relevant to the strategy.

Interaction with regulators

The Committee tracked progress of closure of actions arising from the annual supervisory visit and reviewed management's response to the PRA of confirmation of action completion. We have reviewed management's progress in meeting regulatory expectations in respect to the management of climate change, operational resilience and outsourcing. In the case of operational resilience, the Committee has overseen the recovery of late completion of the Bank's operational resilience self-assessment. We have also reviewed management's response to matters raised in Dear CEO letters.

Committee performance

The Committee has carried out a self-assessment of its performance as well as a review of its Terms of Reference. The results from the former were satisfactory with the suggested actions implemented.

• Report by Iain Laing (continued)

Activities during the year – as highlighted last year

The table below shows the areas highlighted in last year's report on which we planned to focus during this year, and the actions taken.

Area	Progress during 2021/2022
Ensuring the strengthening of retail credit capabilities keeps pace with the growth of retail exposures	- Retail credit risk deep dives have been presented to the Committee, and good progress is evident. - Credit risk roles in first and second line teams have been staffed and are performing. - Credit MI remains an area for development. - The Head of Property Risk has left and a replacement is critical.
Continue to monitor the external environment and the potential COVID-19 implications particularly as government support is unwound	- The external environment has been monitored through ALCO, Credit Risk Committee, BRC and Board through various reports. - Actions resulting from the Russian invasion of Ukraine have been reviewed and supported. - Challenges to margins, profitability, and returns on new lending, driven by the changing market conditions, have been raised in the Risk Committee and main board - Withdrawal of COVID-19 government support has been uneventful, however the environment remains very challenging.
Ensuring effective management of the risks posed by third parties and outsource providers	- Gaps identified in third party management frameworks and compliance with Operational Resilience and Outsourcing regulation require remediation. - Changes in management ownership have been made to improve delivery on this key area of the Committee's concerns.
Continued oversight over the new products and change initiatives required by the Bank's strategy	- The Risk Committee continues to review and challenge the decisions made in management's Product Committee. - Material product proposals/business proposals have been brought to BRC for challenge and oversight. - ICC has provided focused change and oversight over change, escalating issues to BRC. Successful delivery of the Bank's change program has emerged as a key challenge with strategic implications.
Continuing the programme of improvements to the Bank's Risk and Compliance Frameworks	- Risk reporting continues to improve, with the CRO enhancing the clarity and scope of his reports to the Committee throughout the year. - Risk appetite will need further calibration and refinement to align to the strategy revisions agreed during the year.
Embedding and maturing the management of financial risks of climate change	- The Committee reviewed an analysis of the transition risks inherent in the Bank's lending portfolios, and progress against SS3/19. - Further analysis of the Bank's climate exposures has been progressed by management, but has not yet been reviewed by the Committee. - Further review of these risks will be a key focus during 2022/23.
Continuing development of the management information to support risk management across the business	- There has been a significant investment in first line processes to take ownership of risk MI. - Current MI production is very manual in nature. - Completion of the data warehouse rebuild is a key change initiative to improve automation and reliability of MI.

Significant risks and areas of focus

In addition to the activities signposted from last year discussed left, the significant matters addressed by the Committee during the year are summarised in the following table.

Area of focus	Board Risk Committee Activity
Enterprise Risk Management	- The Committee receives regular summaries of risk profile through the Chief Risk Officer's report. - Overseeing continued review and development of risk management frameworks and risk strategy. - The Committee reviewed and approved a first line operational risk and compliance gap analysis and action plan following the emergence of concerns regarding the operating effectiveness of the Operational Risk Framework.
Frameworks & policies	- The Committee received and challenged proposed Commercial Sector credit exposure limits. - The Committee received and challenged proposed revised credit metrics, limits and triggers.
Risk Management	- The Committee received and challenged a review of the Risk function and a maturity assessment of risk management. - The stability and strength of the risk function and key first line functions were regularly reviewed by the Committee and a standing item within the CRO's report. - The Committee approved the risk assurance and compliance monitoring plans for the year. - The Committee oversees quarterly summaries on the second line assurance reviews.
Risk Monitoring	The Committee defines the agenda for a programme of risk deep dives into areas of focus, this year covered; - Vulnerability - Data Protection and Data Privacy - Cyber Control - Operational Resilience - Retail credit risk - Retail arrears management - Commercial credit risk The Committee receives regular reports on the enterprise-wide risk profile of the business. Incidents were raised throughout the year, those of material nature were supported by remediation plans and lessons learnt assessments. The Committee was satisfied with the actions being taken.
Financial resilience and stress testing	During the year the Committee, supported by the Risk Function: - Reviewed and challenged the design and execution of the capital & liquidity adequacy assessment processes (ICAAP & ILAAP), including changes to methodology and assumptions. - Reviewed and challenged the Funding Plan. - Reviewed and challenged the Recovery Plan document, and Recovery Plan fire drill test. - Approval and recommendation to Board for the ICAAP, ILAAP & Recovery Plan.
COVID-19 and Cost of Living	- The Committee oversees the top and emerging risks with COVID-19; a material feature that was a regular feature of discussions - Deep dives of credit portfolios and CRO reporting sought to identify any deterioration in credit quality. - Cyber security deep dive exploring the different threat profile from a working from home environment.

Looking ahead

Looking ahead, I will be encouraging the Committee to focus on the following areas during the next financial year:

- Oversight of management's response to the cost-of-living crisis, and its associated impacts on staff, customers, savings and lending margins and credit portfolio performance;
- Ensuring the embedding of effective operational, conduct and compliance risk management, following-up action plans agreed in 2021/22;
- Ensuring effective management of the risks posed by third parties and outsource providers;
- Ensuring retail and commercial credit management keeps pace with strategic plans for these portfolios;
- Overseeing the performance of key credit portfolio concentrations;
- Continued oversight over the new products and change initiatives required by the strategy;
- Embedding and maturing the management of financial risks of climate change; and
- Continuing development of the management information to support risk management across the business.

Iain Laing
Chair of Board Risk Committee
9 December 2022

Report by Graeme Hughes

Chair of the Nominations and Governance Committee

Equality, diversity and inclusion continues to be a primary focus for the Committee on behalf of the Board.

I am pleased to present my second Nomination and Governance Committee report on behalf of the Board and to provide an overview of the Committee's key activities over the past year and focus over the coming months.

Board Appointments

A key focus of the Committee over the past twelve months has been the vital appointments made at both executive and board level. I would once again like to extend a thank you to Helen Molyneux who finished her non-executive directorship with us in March 2022 following an extension from December 2021 to support the transition of Aileen Wallace as Chair of Remuneration Committee and induction of the Senior Independent Director. Helen's support and knowledge both as Chair of Remuneration Committee and NED over the past six years and during the transition period has been invaluable.

A priority for the Committee at the beginning of the year was the Senior Independent Director recruitment. When engaging in the recruitment process, thoughtful consideration was given to both the current composition of the Board and the skills, knowledge, experience and diversity needed to ensure a further strengthened composition equipped to ensure continued ability to support in the current and future strategic plans of the business. We were therefore delighted to welcome Penny Bickerstaff as Senior Independent Director to the Board in 2022. Penny brings a breadth of experience in both financial services and wider industries following her role as Partner with PwC and brings extensive experience in Finance, Strategy and Change which will be invaluable as we continue with our digital transformation.

Executive Appointments

Following the resignation of Mark Evans, Chief Technology Officer who left the Bank in February 2022 and the Chief People Officer Sarah-Ellen Stacey in September 2021, a review of the leadership needs of the organisation at an executive level were conducted to identify the skills, experience and knowledge required to ensure continued ability of the business to compete effectively in the marketplace. Nikki Harris was appointed as Interim Chief People Officer to allow for the review to be concluded meaningfully and I would like to thank Nikki for her support and guidance during this time.

We are delighted to welcome Tim Thompson as Chief Information Officer who brings a wealth of experience from past roles, most recently in Cumberland Building Society, to define and lead our technology, change and data teams. I am also delighted to have appointed Gareth Thomas who has joined us as Chief People Officer on a permanent basis, we are confident he will bring his expertise as an experienced People leader to further define and embed the People strategy.

Succession Planning

Emphasis on robust succession planning at both board and executive level is maintained by the Committee on behalf of the Board and at the start of this year, the executive level succession plan was reviewed to review the capacity, diversity, skills and competence of the executives and successors. It was noted that **focussed recruitment initiated following the previous year's succession planning had been successful** with some previously identified gaps now being resolved. It was unsurprising when reviewing the depth of the plans, that due to the vacancies and recent recruitment of key executive roles, newly formed gaps had formed which is reflective of this context. Therefore, a primary focus for the Committee over 2023 will be to continue to place emphasis and review the strength of the succession plans, to ensure future capability.

Further to this, the Committee reviewed the leadership capability at a holistic level throughout the business, taking time to define what is meant by leadership at the Bank and the skills or attributes required to be a successful leader at the Bank.

The leadership needs of the business were considered and a skills and attributes matrix has been reviewed and approved by the Committee to support in developing our leaders and to ensure confidence, capability and effectiveness to deliver the business plans. Another Committee activity in 2023 will be to hold the business to account for the further embedding of leadership development.

Culture

A delegated responsibility from the Board to the Committee is to undertake a culture review of the business to ensure honesty, integrity and a continued ability to compete in the marketplace. To enable us to check and challenge ourselves in relation to other firms in the industry, we have maintained our membership with the Financial Services Culture Board (FSCB). The annual FSCB survey exercise enables us to use colleague feedback to assess whether we have the best culture in place for positive customer outcomes while also ensuring a positive colleague experience. I am pleased to confirm that year on year we have continued to improve our benchmarked position with the FSCB reporting, as a result of acting upon focus areas highlighted through our colleague feedback. The 2022 survey has informed us the efforts to engage colleagues on our shared purpose has had a positive impact due to an upturn in scores to questions relating to this. The Committee will continue to review the results of the survey and culture later in the year and will ensure leaders are held to account in prioritising actions in relation to the further feedback shared through the survey.

> "ED&I strategies and actions will also be reviewed to further understand progress and areas of opportunity for the business to improve.

Equality, diversity and inclusion

Equality, Diversity and Inclusion continues to be a primary focus for the Committee on behalf of the Board. Alongside the culture review planned for later in the year, **ED&I strategies and actions will also be reviewed to further understand progress and areas of opportunity for the business to improve**.

The Board is committed to having a diverse leadership team to benefit from the different insights and experiences that diversity brings and to also ensure leaders are harvesting a culture of inclusivity and equality so that everyone can be their best self at work. As part of our commitment to this, the Bank joined the Women in Finance Charter in 2019 with a pledge to work towards a leadership team made up of 45% female leaders by 2022. I am disappointed to note that we have not achieved our target but we will be re-pledging to the Women in Finance Charter with a revised target and will take forward the lessons learned from our time with the Charter to ensure we are maximising efforts in achieving gender parity.

I am pleased to note that we are moving forward in all other areas of ED&I, particularly with improving our data that we hold for colleagues by 20% in the last year to allow us to further understand the makeup of the business, our colleagues needs and what more we can do to further maintain a diverse organisation of inclusivity.

2023 and beyond

The activities and priorities for the Committee over the coming year will be pivoted around holding ourselves to account to the commitments made throughout the year, particularly in relation to the development of leaders, culture and equality, diversity and inclusion. Activities will include:

- Further reviewing the strength and depth of both the Board and Executive succession plans following our recent appointments;
- Reviewing the leadership capabilities throughout the organisation to further ensure capabilities and effectiveness;
- Holding ourselves to account in relation to the equality, diversity and inclusion strategy, reviewing areas of progress and areas of actions; and
- Completing a deeper dive into the FSCB survey and colleague feedback to gain a full understanding of the culture of the organisation, ensuring that the purpose and values of the organisation are fully embedded and lived by our colleagues.

Graeme Hughes
Chair of the Nominations and Governance Committee
9 December 2022

Report by Aileen Wallace

Chair of the Remuneration Committee

In ensuring the Committee delivers upon its responsibilities, approach and adheres to our key principles, the broad activities below were undertaken during the year.

This is my first report as Chair of the Remuneration Committee, enabling me to have the pleasure of being able to pass on my gratitude to Helen Molyneaux, both personally and on behalf of the entire Board, for her steadfast stewardship of the Committee during her tenure as Chair.

For the year 2021/2022,on behalf of the Board, I am pleased therefore to present our Remuneration Report and would like to thank my colleagues and our Interim Chief People Officer, Nikki Harris, whose support was invaluable during the Chair transition process. I would also like to take this opportunity to welcome Penny Bickerstaff, our Senior Independent Director, who joined our Committee during the year. The Committee believes that the Bank's culture and values are embodied in our overall approach to total reward and this is brought to life for our colleagues and our organisation within our Remuneration Policy. The key drivers underpinning our policy are:

- To align pay with the strategic objectives of the Bank and its values;
- To support the provision of a flexible package which is sufficiently competitive to enable the recruitment and retention of people who are aligned to our purpose and motivated to deliver a first-class experience for our customers; and
- To set out the structures and controls in place to ensure our remuneration is effective, fair and meets our obligations.

Remuneration approach across the Bank

Our role is to provide oversight of remuneration and benefits across the Bank and to do so for all of our colleagues.

Executive Director's remuneration comprises a salary, appropriate benefits and pension provisions with a variable reward which is delivered through an annual bonus, in line with good governance and our regulatory responsibilities.

For our wider colleague population, the Committee seeks to have a remuneration structure that is simple, delivers variable reward which is valued by colleagues, and aligned to good market practice. This wider colleague remuneration comprises a salary, benefits, pension provisions and a variable award. Those colleagues who are deemed to be Material Risk Takers will have any variable award delivered in line with regulatory requirements.

In ensuring the Committee delivers upon its responsibilities, approach and adheres to our key principles, the broad activities below were undertaken during the year.

2022 Activities

- The Committee reviewed and updated our Remuneration Policy and this was approved by our Shareholder;
- CPO and CIO appointments were made, following the approval by the Committee of the appropriate remuneration recommendations made by the CEO;
- Changes to variable reward plans were made, in line with our agreed strategy, creating a single Annual Reward Plan (ARP) for colleagues and senior executives;
- The Committee approved the new Bank-wide balanced scorecard measures to be used in the new Annual Reward Plan, ensuring variable reward outcomes across our organisation reflected the strength, prudence and cultural values held across financial and non-financial measures;
- We approved the inclusion of our key control colleagues within our Annual Reward Plan (ARP), in line with our culture and values working as a united team, prudently managing and controlling risk in

• Report by Aileen Wallace (continued)

the achievement of our strategy;

- Strong links with this Committee and our Board Risk Committee were embedded via our approach to Risk Adjustment and how we independently assess variable reward for key control colleagues;
- We reviewed the remuneration outcomes for senior executives and Material Risk Takers, considering any application of our discretionary framework and in considering risk adjustments;
- We continued to benefit from salary benchmarking analysis and via Deloitte, receive expert remuneration consultancy guidance, with specific and focused engagement held during the development of our new Annual Reward Plan (ARP);
- Our recognised list of Material Risk Takers was reviewed, challenged and approved;
- We considered and reviewed remuneration outcomes across our colleague population, taking our internal operating environment into account as well as proportionality;
- Our approach to salary benchmarking and increases to salary was reviewed across the workforce, taking into account market forces and our own strategy and market positioning;
- We reviewed our Gender Pay reporting and the drivers of acquisition and retention, such as our role levelling approach and policies such as parental leave and menopause support. The Committee agreed that while our remuneration approach is an enabler to balanced gender recruitment, as an organisation who has scaled its colleague base by a third in the last 12 months, with the majority in less senior roles, a deeper focus on gender balance succession is required. Key drivers of this activity were introduced, such as diverse shortlists and selection panels;
- The Committee discussed our approach to performance management given our scaling workforce and agreed further oversight on this area for the year ahead.

2023 planned activities

- The Committee will keep the effectiveness of the Remuneration Policy under review, in line with our strategy, ensuring it continues to meet the drivers of our approach to talent acquisition, retention, motivation and cultural intent;
- Focus will be given to key succession planning, viewed through the lens of gender balance, including remaining alert to further drivers of remuneration in this area;
- Our capability in delivering performance management in line with our expectations and within our cultural values, will be monitored throughout the year;
- Oversight of our all colleague Annual Reward Plan.

Variable reward outcomes for 2022

For all colleagues', including Executive Directors, the annual bonus in relation to performance during 2022 was based on a balanced scorecard of performance measures and objectives, weighted between financial (40%), risk & regulatory (20%), customer (20%) and building our future (20%).

At the October 2022 Remuneration Committee meeting, the Committee considered the balanced scorecard outcome. The Committee decided to use its discretion, taking into account the following considerations:

- Shareholder experience – we remain focused in our approach to remuneration, and this is particularly true until there is sustained improvement to shareholder value;
- Underlying performance of the Bank and progress against strategic priorities – we are moving with targeted focus on our strategic plan;
- Hard work and dedication of our colleagues – colleagues and the management team have continued to work diligently and given market and social forces, we remain alert to the need to maintain colleague motivation and overall sense of contribution;
- Affordability in the context of the Bank's profitability being less than the expectations of our Shareholder.

The Committee wanted to strike the right balance between the interests of our Shareholder and rewarding our colleagues for the progress made while encouraging them to continue to raise the bar. As a result, the variable reward awarded was felt to be the right compromise between these interests and therefore the Committee felt it appropriate to offer variable reward to all colleagues.

Looking forward to 2023

Salaries from 1st November 2022

We undertook our annual pay review, benchmarking fixed remuneration with external support. As a result of this pay review, a small number of colleagues have received salary alignment to external reward guidance.

Our budget for salaries this year has been utilised to continue our approach to fair pay across the Bank, ensuring recognition of the UK Living Wage, where our most junior colleagues received a 7% pay rise, with the remainder of our colleagues, receiving a 5% pay rise. All colleagues, excluding our highest Band individuals, also received an additional cost of living payment.

Our Executive Directors will also receive a 5% pay rise, reflecting the view of the Committee on the criticality of these individuals to deliver our strategic plan and recognising that fixed pay remains an important factor in supporting all of our colleagues against the backdrop of challenging economic times.

Variable reward for 2023

The Committee has agreed an appropriate bank-wide balanced scorecard to inform the Company variable reward adjustment factor for 2023, continuing our focus on financial, risk, customer and building our future objectives.

Our simplified approach to variable reward, applied across the organisation, focuses all colleagues on growth and the long-term, sustainable success of the business. Our Shareholder has been consulted on a regular basis on the key strategic matters before the Remuneration Committee, including the design of the annual reward scheme to ensure alignment with shareholder interests.

Like many organisations, the Committee has been required to apply its discretion in deciding the remuneration outcomes for the year. Not only has the Committee had to consider the impact of the extraordinary economic operating environment on business performance, it has been conscious of the adjustment to a new operating norm that colleagues have faced during the year. Notwithstanding these challenges, the Committee recognises that progress has been made in delivering the Bank's strategy and feels that a resilient and responsive remuneration approach is a key enabler for the future.

A Wallace

Aileen Wallace
Chair of the Remuneration Committee
9 December 2022

Report by Aileen Wallace

Chair of the Innovation and Change Committee

I am pleased to be able to report that the Committee has observed sustained progress in all of the key areas of focus.

At this time last year, I was able to report on behalf of the Board that our newly introduced Committee, focusing on Innovation and Change, had successfully embedded strong foundations towards our purpose in making life better for customers and society in the moments that matter.

Key building blocks of our innovation foundations have been the growth of colleague enablement via technology deployment, the leveraging of external experience via relationships with key partners and our unrelenting focus on executing capabilities that are hard wired to our strategic outcomes.

> 2022 has been an important year for our organisation as we mature from refining our existing capabilities towards a greater strategic impetus on technology value creation.

2022 has been an important year for our organisation as we mature from refining our existing capabilities towards a greater strategic impetus on technology value creation. In this regard, it has truly been a transitional year.

Looking back at 2022

In setting our agenda for such a transitional year, the following were our agreed areas of focus:

- Supporting our executive team in elevating their innovative thinking in delivering unique value-added benefits and ensuring core building blocks are delivered;
- Monitoring our talent programmes and industry responses to continuing digital demand;
- Ensuring optimal outcomes from our new third party delivery partnership, where we can leverage scale and optimise resources;
- Ongoing development of our cost benefit analysis to ensure that we remain on track to deliver our planned technology strategy; and
- **Innovating our responses to the cyber threat landscape, meeting pace with pace.**

I am pleased to be able to report that the Committee have observed sustained progress in all the key areas of focus. However, there still remains more to be done. In order to fully deliver our business strategy, we need to be relentless, continually innovating "by thought and by design" and be forensic in our delivery, on budget and on time. As a result, the Committee will continue to review our support and oversight to achieve innovation oriented thinking and remain diligent in our oversight of technology cost benefit achievement. It is recognised that welcoming our new Chief Information Officer to the business, who joined us in the last quarter of this year, will provide additional insight to our innovation thinking and we look forward to the enrichment this will bring.

The Committee additionally afforded specific focus to the following topics during the year:

- Additional assurance over our Cyber Framework, operating controls and capability, with reporting to the Committee on the threat landscape. In line with our operating controls posture, and our goal in innovating responses to this landscape, the Committee reviewed and approved management's recommendation for a new Security Operations Centre (SOC), further enhancing our overall defence and responsiveness;
- Oversight of plan performance towards the execution of a new Digital Savings Platform in support of the "digital first" requirements of our Savings Strategy and performance monitoring of our key partners providing additional programme strength and depth;
- **Business Intelligence and our "Be Driven by Data" approach was fully reviewed, ensuring the management of data as a valuable asset and the ability to leverage this asset value remains a core strategic pillar.** The Committee noted the business intelligence strategic roadmap presented and observed the strong alignment of activity across the business, both in data intelligence and data risk management;
- Reviewing our Supplier Management Framework and evidence of assurance over the performance of our partners and suppliers. This remains an important area in relation to operational resilience and the cultural tone of our supply chain. As such, the Committee regards this as a key area for continued review in 2023;
- Maturity of the independent key control function challenge to the Committee on core agenda items. With the appointment of a dedicated IT and Security Subject Matter Expert to our key control team under the leadership of our Chief Risk Officer during the year, this affords the Committee an enhanced independent perspective and opinion to matters under Committee review. As a result, the Committee look forward to observing this maturity during the next 12 months.

With our foundations now embedded and a strong operating rhythm and schedule in place, our priority for 2023 is overseeing unique value being delivered, via technology, to our strategic plan, enabling us to deliver on our organisational purpose.

A Wallace

Aileen Wallace
Chair of the Innovation and Change Committee
9 December 2022

Directors' Report

The Directors present their report together with the audited financial statements for the year ended 30 September 2022. Certain disclosures are given in the Chairman's Statement, Strategic Report and the financial statements and are incorporated here by cross-reference. Specifically, these incorporate the following disclosures:

Group strategy - page 4

Financial performance review - page 10

Risk management policies - page 16

Derivative financial instruments - note 22

Directors and Directors' interests

The Directors who held office during the year were as follows:

David Landen (CEO)

Matthew Burton (Deputy CEO)

Janet Preece (CFO)

Graeme Hughes* (Chairman)

Aileen Wallace*
(Non-Executive Director)

Iain Laing* (Non-Executive Director)

Penny Bickerstaff*
(appointed 22 September 2022)

Helen Molyneux*
(Non-Executive Director)
(resigned 24 March 2022)

John Barbour*
(Non-Executive Director)

No contract was entered into by the Bank in which a director had a material interest.

*All non-executive Directors are deemed to be independent by the Board. None of the Directors held any interests in the shares of any group companies.

During the year, there were no contracts entered into by the Bank in which the Directors had a material interest.

Political contributions

The Bank made no political contributions during either year.

Post balance sheet events

There were no post Balance Sheet events to disclose.

Results and dividends

The profit for the year after taxation from continuing activities amounted to £4.8m (2021: profit of £5.8m).

No dividends have been declared or paid during the year.

Qualifying third-party indemnity provisions

The Bank has granted an indemnity to one or more of its Directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies' Act 2006. Such qualifying party indemnity provisions remain in force as at the date of approving the Director's Report.

Re-appointment of auditors

A resolution for the re-appointment of Ernst & Young LLP as auditor of the Company is to be proposed at the forthcoming Annual General Meeting of the Company's parent, The Carlyle Trust Limited.

Going concern

The Directors have considered the appropriateness of the going concern basis of preparation of the financial statements taking into account the Bank's current and projected performance, including consideration of projections incorporating the impact of the higher interest rate and high inflation environment on the Bank's capital and funding position. As part of this assessment the Board considered:

- The impact on Bank's profits from an expected reduction in income from retail and commercial lending combined with increased credit impairment charges;
- The sufficiency of the Bank's capital base, which is expected to be sufficient to weather even a severe high interest rate environment; and,
- The adequacy of the Bank's liquidity.

The Bank's forecasts and projections include scenario testing undertaken in accordance with the Internal Capital Adequacy Assessment Process and Internal Liquidity Adequacy Assessment Process, which are required by the Prudential Regulation Authority to demonstrate appropriate levels of capital and liquidity respectively under stressed conditions.

The Directors confirm that they are satisfied that the Bank will continue in business for a period to 31 December 2023. Consequently, the going concern basis continues to be appropriate in preparing the financial statements.

By order of the Board

David Landen
Chief Executive Officer

9 December 2022

Statement of Directors' Responsibilities

Directors' Responsibilities Statement

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the 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 Accounting Standards and applicable law (UK Generally Accepted Accounting Practice) including Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101).

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 Company and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in FRS 101 is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the company's financial position and financial performance;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

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 Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They 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.

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

Each of the Directors who is a director at the date of the approval of this Annual Report confirms to the best of their knowledge:

- The Bank's financial statements prepared in accordance with FRS 101, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Bank.
- The Strategic Report includes a fair view of the development and performance of the business and the position of the Bank together with the description of the principal risks and uncertainties that it faces.
- The Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for the Shareholder to assess the Bank's position and performance, business model and strategy.
- The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Bank's auditor is unaware; and each director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the Bank's auditor is aware of that information.

By order of the Board

David Landen
Chief Executive Officer

9 December 2022

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Independent Auditor's Report

to the Member of Julian Hodge Bank Limited

Opinion

We have audited the financial statements of Julian Hodge Bank Limited for the year ended 30 September 2022 which comprise the Income Statement, Statement of Other Comprehensive Income, Balance Sheet, Statement of Changes in Equity and the related notes 1 to 33 (except for note 28 which is unaudited), including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards including FRS 101 Reduced Disclosure Framework (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the Company's affairs as at 30 September 2022 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- 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 under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the Directors' assessment of the Company's ability to continue to adopt the going concern basis of accounting included:

- In conjunction with our walkthrough of the Company's financial close process, we confirmed our understanding of management's going concern assessment process, and confirmed their assessment covered all key factors;
- We evaluated management's going concern assessment, which included reviewing their evaluation of long-term business and strategic plans, capital adequacy, liquidity, and funding positions. We also verified that the Company's risk management practices were considered, including credit risk, market risk and operational risks;
- We agreed key assumptions and data in management's going concern assessment to underlying other supporting documentation;
- We assessed the results of management's stress testing, including consideration of principal and emerging risks relating to funding, capital, and liquidity;
- We reviewed the future profit forecasts, including assessing the reasonableness of assumptions, and historical forecasting accuracy;
- We reviewed correspondence with the regulators for any matters that may impact going concern assessment; and
- We evaluated the adequacy of the Directors' disclosure in relation to going concern in the Directors' Report and notes to the financial statements.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of fifteen months to 31 December 2023.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

Overview of our audit approach

Key audit matters	- The risk that inappropriate property / collateral valuations are applied in the calculation of the IFRS 9 expected credit loss (ECL) provision (Stage 3 credit impairment provision on loans and advances to customers). - The risk of incorrect valuation of derivatives.
Materiality	- Overall materiality of £2.7m which represents 1.5% of equity.

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

Climate change

There has been increasing interest from stakeholders as to how climate change will impact the Company. The Company has determined that the most significant future impacts from climate change on its operations will be on the valuation of collateral held as part of loans and advances and the fair value of investment properties, as explained on page 18. These have been identified through the process explained on page 22 in the Risk Management Report, which form part of the "Other information," rather than the audited financial statements. Our procedures on these disclosures therefore consisted solely of considering whether they are materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appear to be materially misstated

As explained in the Risk Management Report referenced above and in note 1 of the financial statements, governmental and societal responses to climate change risks are still developing, and are interdependent upon each other, and consequently financial statements cannot capture all possible future outcomes as these are not yet known.

The degree of certainty of these changes may also mean that they cannot be taken into account when determining asset and liability valuations and the timing of future cash flows under the requirements of FRS 101.

Our audit effort in considering climate change was focused on evaluating management's assessment of the impact of climate risk, including physical and transition, and ensuring that the effects of material climate risks have been appropriately reflected in the financial statements.

Whilst the Company has stated its commitment to aspirations to achieve net zero, the Company is currently unable to determine the full future economic impact on their business model, operational plans and customers to achieve this and therefore as set out above the potential impacts cannot be fully incorporated in these financial statements

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included 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. These matters were addressed in the context of our audit of the financial statements as a whole, and in our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
The risk that inappropriate property/collateral valuations are applied in the calculation of the IFRS 9 ECL provision (Stage 3 collateral value £12.3m; 2021:£16.5m). Refer to the accounting policy for measurement of ECL and Notes 14 and 27 to the financial statements. The assessment of the expected credit loss provision is inherently judgemental. Given the highly collateralised nature of the loan portfolio, collateral values are the most sensitive variable to the overall ECL calculation.	We performed a walkthrough to understand the IFRS 9 ECL process. We also reviewed the provisioning methodology to verify compliance with IFRS. For a sample of Stage 3 commercial loans we utilised our property valuation specialists to perform an independent valuation of the collateral used within the ECL provision calculation. The sample we tested in our audit covered £15.9m, 99% (2021:£16.4m, 99%) of the collateral value for the Stage 3 loans.	The valuation of Stage 3 property loans collateral was determined to be within an acceptable range.
The risk of incorrect valuation of derivatives: £64.4m asset (2021: £14.7m liability) Refer to the accounting policy for financial instruments and Note 22 to the financial statements. The Company holds a significant number of derivative financial instruments, which it uses to manage interest rate risk. The valuation of these derivatives is determined through the application of valuation techniques which often involve the exercise of judgement and the use of assumptions and estimates. Due to the significance of the financial instruments and the related estimation uncertainty this is considered a key audit matter.	We performed a walkthrough to understand the derivatives valuation process including design of the controls. We took a substantive approach for the testing of derivative valuation. Utilising our derivative valuation specialists, we independently valued a sample of derivative financial instruments. We compared our independent valuation to management's valuation and considered whether management's value was within an acceptable range.	The valuation of derivatives was determined to be within an acceptable range.

In the prior year, our Auditor's Report included a key audit matter in relation to inappropriate actuarial assumptions being used in the valuation of investment properties (reversionary interest in properties). Following the sale of the portfolio of live reversionary policies during the year, this risk is no longer applicable to the Company.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality

The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Company to be £2.7million (2021: £2.2 million), which is 1.5% (2021: 1.5%) of equity. We believe that equity is an appropriate basis as the key stakeholders (including the principal shareholder and the PRA) are focused on the financial strength and solvency position of the business, which is represented in the financial statements by equity.

During the course of our audit, we reassessed initial materiality and confirmed that the final materiality was in line with initial materiality.

Performance materiality

The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 75% (2021: 75%) of our planning materiality, namely £2m (2021: £1.7m). We have set performance materiality at this percentage because our prior year audit experience indicates a lower risk of misstatements, both corrected and uncorrected.

Reporting threshold

An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.1m (2021: £0.1m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the Annual Report, other than the financial statements and our Auditor's Report thereon. The Directors are responsible for the other information contained within the Annual Report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements;

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or Directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Responsibilities of Directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 31, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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 an Auditor's Report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a 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 the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect irregularities, including fraud. The risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the Company and management.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and determined that the most significant are those that related to the reporting framework (FRS 101 and the Companies Act 2006), license conditions and supervisory requirements under the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA), and the relevant direct and indirect tax compliance regulation in the United Kingdom.
- We understood how the Company is complying with those frameworks by making inquiries of management, those charged with governance and those responsible for legal and compliance matters. We corroborated our inquiries through review of meeting minutes of the Board and the Board committees and internal audit reports and noted that there was no contradictory evidence.
- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur by considering the controls that the Company has established to address risks identified by the entity, or that otherwise seek to prevent, deter or detect fraud. We identified the risk of material fraud through management override of controls by assessing revenue, specifically topside manual adjustments to revenue, to be subject to fraud risk. Our audit procedures included testing a sample of journals to verify the transactions were appropriate and supported by source documentation.
- Based on this understanding, we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved making inquiry about the policies that have been established to prevent non-compliance with laws and regulations, inquiring about the Company's methods of enforcing and monitoring the compliance with such policies, reviewing complaints log, and inspecting significant correspondence with the FCA and PRA.
- The Company operates in the banking and capital markets industry which is a specialised area. As such, the Senior Statutory Auditor considered the experience and competence of the engagement team to ensure that the team had appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: **https://www.frc.org.uk/auditorsresponsibilities**.

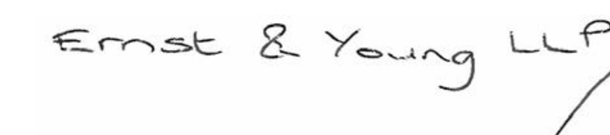
This description forms part of our Auditor's Report.

Other matters we are required to address

- We were appointed by the Company on 22 April 2016 to audit the financial statements for the year ending 31 October 2016 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments is 7 years, covering the years ending 31 October 2016 to 30 September 2022.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Company and we remain independent of the Company in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee.

Use of our report

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.



Robin Enstone
(Senior statutory auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

Bristol

9 December 2022

4 Financial Statements

Income Statement

For the year ended 30 September 2022

	Notes	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m
Interest receivable and similar income	4	50.5	39.6
Interest payable and similar charges	5	(21.1)	(22.0)
Net interest income		**29.4**	**17.6**
Fees and commissions receivable		2.6	2.5
Fees and commissions payable		(0.1)	-
Net fee and commission income		**2.5**	**2.5**
Investment income		6.7	6.0
Other operating income		-	0.1
Net operating income		**38.6**	**26.2**
Administrative expenses	6	(34.2)	(25.9)
Depreciation and amortisation	15/16	(2.5)	(2.4)
Impairment gains/(losses) on loans and advances to customers	14	-	(0.3)
Bad debt recovery		0.4	0.3
Operating profit/(loss)		**2.3**	**(2.1)**
Other fair value gains	7	4.3	11.3
Loss on disposal of loans and advances to customers held at fair value		-	(5.5)
Profit before taxation	8	**6.6**	**3.7**
Tax (charge)/credit on profit	9	(1.8)	2.1
Profit for the financial year		**4.8**	**5.8**

Statement of Other Comprehensive Income

For the year ended 30 September 2022

	Notes	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m
Profit for the financial year		**4.8**	**5.8**
Items that will not be reclassified subsequently to profit and loss			
Re-measurement of defined benefit pension plan	24	9.0	2.6
Deferred tax thereon	18	(2.2)	(0.4)
Movement of pension scheme reimbursement asset	23/24	(0.2)	(1.0)
Deferred tax thereon	18	-	0.6
Total other comprehensive income		**6.6**	**1.8**
Total comprehensive income for the year		**11.4**	**7.6**

The results for the year ended 30 September 2022 relate entirely to continuing operations.

The notes on pages 39 to 69 form part of the financial statements of the Bank.

Balance Sheet

As at 30 September 2022

	Notes	30 September 2022 £m	30 September 2021 £m
Assets			
Cash and balances held at central banks		118.1	412.2
Loans and advances to credit institutions	10	0.2	45.9
Derivative financial instruments	22	75.8	-
Government bonds	11	111.2	29.8
Debt securities	12	116.2	42.3
Loans and advances to customers	13	1,404.6	1,061.5
Intangible assets	15	9.7	7.4
Property, plant & equipment	16	1.5	1.6
Investment properties	17	9.2	94.6
Deferred tax assets	18	6.3	11.5
Other assets	19	8.0	6.6
Total assets		**1,860.8**	**1,713.4**

	Notes	30 September 2022 £m	30 September 2021 £m
Liabilities			
Deposit from banks	20	221.0	145.0
Deposits from customers	21	1,425.0	1,381.0
Derivative financial instruments	22	11.4	14.7
Other liabilities	23	13.9	9.9
Pension liabilities	24	4.5	14.2
Total liabilities		**1,675.8**	**1,564.8**
Share capital and reserves			
Share capital	25	130.0	105.0
Other reserves		55.0	43.6
Total equity		**185.0**	**148.6**
Total equity and liabilities		**1,860.8**	**1,713.4**

These financial statements of the Bank were approved by the Board of Directors on 9 December 2022 and were signed on its behalf by:

David Landen
Director

Statement of Changes in Equity

For the year ended 30 September 2022

	Called up share capital £m	Retained earnings £m	Pension reserve £m	Total £m
2022				
At beginning of the financial year	105.0	54.3	(10.7)	148.6
Issue of share capital	25.0	-	-	25.0
Profit for the financial year	-	5.2	(0.4)	4.8
Other comprehensive income	-	-	6.6	6.6
Pension additional contribution	-	(1.2)	1.2	-
At end of the financial year	**130.0**	**58.3**	**(3.3)**	**185.0**

	Called up share capital £m	Retained earnings £m	Pension reserve £m	Total £m
2021				
At beginning of the financial year	105.0	50.4	(14.4)	141.0
Profit for the financial year	-	5.5	0.3	5.8
Other comprehensive income	-	-	1.8	1.8
Pension additional contribution	-	(1.6)	1.6	-
At end of the financial year	**105.0**	**54.3**	**(10.7)**	**148.6**

Notes to the Financial Statements

For the year ended 30 September 2022

1. Accounting policies

Basis of preparation

The financial statements of the Bank are prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101).

The Bank is a privately-owned Company incorporated and registered in England and Wales.

In preparing these financial statements, the Bank applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards in conformity with the requirements of the Companies Act 2006, applicable to companies reporting under IFRS (Schedule 2 of The Large and Medium-sized Companies and Banks (Accounts and Reports) Regulations 2008) and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

The immediate parent undertaking of the Bank is Hodge Limited. The ultimate parent undertaking and controller is The Carlyle Trust (Jersey) Limited (incorporated in Jersey). Within the meaning of the Companies Act 2006, The Carlyle Trust Limited is the parent undertaking of the only group of undertakings for which group accounts are drawn up and of which the Bank is a member. The accounts of The Carlyle Trust Limited can be obtained from: The Company Secretary, Julian Hodge Bank Limited, One Central Square, Cardiff, CF10 1FS.

In these financial statements, the Bank has applied the exemptions available under FRS 101 in respect of the following disclosures:

- A Cash Flow Statement and related notes;
- Reconciliation between carrying amounts of investment properties at the beginning and at the end of the period;
- Disclosures in respect of transactions with members of a group; and
- Disclosures in respect of the compensation of key management personnel and related parties.

The Bank proposes to continue to adopt the reduced disclosure framework of FRS 101 in its next financial statements.

The financial statements have been prepared on a going concern basis. The Board has considered the appropriateness of the going concern basis of preparation of the financial statements taking into account the Bank's current and projected performance, including consideration of projections incorporating the impact of the higher interest rate and high inflation environment on the Bank's capital and funding position. As part of this assessment the Board considered:

- The impact on Bank's profits from an expected reduction in income from retail and commercial lending combined with increased credit impairment charges;
- The sufficiency of the Bank's capital base, which is expected to be sufficient to weather even a severe high interest rate environment; and
- The adequacy of the Bank's liquidity.

The Bank's forecasts and projections include scenario testing undertaken in accordance with the ICAAP and ILAAP, which are required by the Prudential Regulation Authority to demonstrate appropriate levels of capital and liquidity respectively under stressed conditions.

The Directors confirm that they are satisfied that the Bank will continue in business for a period to 31 December 2023. Consequently, the going concern basis continues to be appropriate in preparing the financial statements.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Climate Risk:

The Bank has assessed the impact of climate risk on the financial statements. As set out on page 22, the Bank has considered the impact of both physical and transition risks from climate change as an emerging risk. The potential areas this could impact are loans and advances to customers and investment properties. As part of this assessment, three scenarios were considered: flood, subsidence and coastal erosion and the estimated time horizon for the impact is considered to be between 2030 and 2060. Under each scenario, the Bank assessed the financial impact on the valuation of collateral held, which supports the carrying value of loans and advances to customers and the fair value of investment properties. The Bank considered the underlying loan to value and energy performance certificate profiles of the portfolio as part of this assessment. Based on the Bank's current assessment, the exposure to financial risk from climate change is not considered to be material as the Bank considers climate risk to have limited impact in the immediate term. The longer-term risk will be mitigated through the Bank's business strategy and financial planning. Government and societal responses to climate change risks are still developing and are interdependent upon each other and consequently, financial statements cannot capture all possible future outcomes as these are not yet known.

Standards and interpretations effective for the Company in these financial statements:

The Company has considered a number of amendments to published International Financial Reporting Standards and interpretations effective for the year ended 30 September 2022. They are either not relevant to the Bank or do not have a significant impact on the Bank's financial statements.

Standards and interpretations effective for the Company in future periods:

None of the standards issued by the IASB but not yet effective, are expected to have a material impact on the Bank's financial statements in future periods.

Summary of Significant Accounting Policies

Measurement convention

The Bank prepares its accounts under the historical cost convention, except for certain financial assets and liabilities held at fair value.

Interest receivable and interest payable

Interest income and expense are recognised in the Income Statement for all instruments measured at amortised cost using the effective interest rate method. The Bank estimates future cash flows considering all contractual terms of the financial instrument. 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. The net incremental transactional income/costs are amortised over the period to the contractual maturity date for commercial loans and based on the expected life of each loan for Retail and Buy-to-Let portfolios. An allowance is made for prepayments for the Retail portfolios, but no adjustment is made for the Commercial and Portfolio Buy-to-Let portfolios.

The gross carrying amount of a financial asset is the amortised cost of a financial asset before adjusting for any loss allowance. For credit-impaired financial assets i.e. Stage 3, a credit-adjusted effective interest rate is calculated using estimated future cash flows including loss allowance. The Bank does not currently hold any purchased or originated credit-impaired financial assets.

If the status of the asset subsequently recovers, the amount by which the provision has increased due to suspended interest is recognised as a reversal of impairment loss allowance rather than interest income. The reversal of impairment loss allowance will not be recognised until any recovery is completed.

Revenue Recognition

Investment income

Investment income consists of realised gains on financial assets and liabilities held at fair value through profit and loss (FVTPL).

Realised gains and losses on financial assets and liabilities held at fair value represent the difference between the proceeds received, net of transaction costs, and the original cost.

Fees and commissions

Fee and commission income primarily relate to fees for originating and servicing mortgages on behalf of third parties. Fee income is recognised when performance obligations attached to the fee or commission have been satisfied.

Financial instruments

Recognition

Financial assets and liabilities are recognised when the Bank becomes a party to the contractual provisions of the instrument. Purchases and sales of financial assets are recognised on the date in which they are settled.

Financial assets

The Bank has classified its financial assets as follows:

- Amortised cost: Cash and balances held with central bank, Retail, Portfolio Buy-to-Let and Commercial loans, Loans and advances to credit institutions, Government bonds, Debt securities and Other assets. These assets are held within a business model whose objective is to hold assets to collect contractual cash flows and the contractual terms of the loans are solely payments of principal and interest on the principal amount outstanding.
- FVTPL: Lifetime mortgages including Retirement mortgages are classified as FVTPL due to the existence of an embedded derivative in the form of a 'No negative equity guarantee' (NNEG) which forms part of the terms and conditions applicable to this products.
- In 2022, Derivative assets are classified as FVTPL.

To classify financial assets the Bank performs two assessments to evaluate the business model in which financial assets are managed and their cash flow characteristics.

The 'business model assessment' is performed at a portfolio level and determines whether the Bank's objective is to generate cash flows from collecting contractual cash flows, or by both collecting contractual cash flows and selling financial assets.

The assessment of cash flow characteristics determines whether the contractual cash flows of the financial asset are solely payments of principal and interest on the principal amount outstanding (SPPI). The SPPI test is performed at an instrument level based on the contractual terms of the instrument at initial recognition. For the purposes of the SPPI test, principal is defined as the fair value of the financial asset at initial recognition. Interest is defined as consideration for the time value of money and credit risk associated with the principal amount outstanding and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as a reasonable profit margin.

A financial asset is classified as measured at amortised cost if it meets both of the following conditions and is not designated as being held at FVTPL:

- It is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- Its contractual terms give rise on specified dates to cash flows that are SPPI.

The Bank does not hold any financial instruments that are classified and measured at fair value through other comprehensive income, accordingly all financial assets not classified as measured at amortised cost are classified as FVTPL.

On initial recognition, the Bank may irrevocably designate a financial asset as FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Financial liabilities

The Bank has classified its financial liabilities as follows:

- Amortised cost: Deposits from banks, Deposits from customers and Other liabilities.
- FVTPL: Derivatives.

De-recognition of financial assets and financial liabilities

(i) Financial assets

Financial assets are de-recognised when:

- The rights to receive cash flows from the asset have expired;
- The Bank has transferred its rights to receive cash flows or has assumed an obligation to pay the received cash flows in full without material delay; and either
- The Bank has transferred substantially all the risks and rewards of the asset; or
- The Bank has neither transferred nor retained substantially all the risks and rewards of the asset but has transferred control of the asset.

Where an existing financial asset is replaced by another to the same customer on substantially different terms, or the terms of an existing facility are substantially modified, such an exchange or modification is treated as a de-recognition of the original asset and the recognition of a new asset.

(ii) Financial liabilities

Financial liabilities are de-recognised when the obligation is discharged, cancelled or has expired.

Fair value of financial instruments

On initial recognition, the best evidence of the fair value of a financial instrument is normally transaction price (i.e. the fair value of the consideration given or received). If the Bank determines that the fair value on initial recognition differs from the transaction price, the Bank accounts for such differences as follows:

- If fair value is evidenced by a quoted price in an active market for an identical asset or liability or based on a valuation technique that uses only data from observable markets, then the difference is recognised in the Income Statement on initial recognition (i.e. day 1 profit or loss);
- In all other cases, the fair value will be adjusted to bring it in line with the transaction price (i.e. day 1 profit or loss will be deferred by including it in the initial carrying amount of the asset or liability). Subsequently, the deferred gain or loss will be released to 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.

The Bank uses a fair value hierarchy that categorises financial instruments into three different levels as detailed in note 26. Levels are reviewed at each reporting date and this determines whether transfers between levels are required.

Retirement mortgages

On initial recognition, the fair value of retirement mortgages is calculated by discounting the future expected cash flows at swap rates together with an allowance for illiquidity. The illiquidity spread is informed by examining the pricing of new originations amongst other market participants, creating a market consistent discount rate for the asset.

On subsequent measurement, the value of retirement mortgages is calculated by projecting the cash flows expected to be generated by the portfolio on redemption, allowing for credit losses caused by the no-negative equity guarantee using a variant of the Black Scholes option pricing method. These cash flows are then discounted at the swap yield plus a margin to reflect the illiquidity of retirement mortgage assets, as described above. An allowance for possible early redemption of the retirement mortgages has been determined by reference to historical rates of lapse within the portfolio.

Embedded derivatives

The NNEG is an embedded derivative. The Bank does not separate the NNEG embedded derivative from the host instrument. The fair value of retirement mortgages takes into account an explicit provision in respect of the NNEG. Further details are disclosed in note 26(d).

• Accounting policies (continued)

Measurement of Expected Credit Loss (ECL)

Impairment of financial assets is calculated using a forward looking ECL model. The Bank records an allowance for ECLs (loss allowance) for all financial assets not held at FVTPL.

Measurement of ECLs depends on the 'stage' of the financial asset, based on changes in credit risk occurring since initial recognition, as described below:

- **Stage 1**: when a financial asset is first recognised it is assigned to Stage 1 and a 12-month ECL is recognised. If there is no significant increase in credit risk from initial recognition the financial asset remains in Stage 1.
- **Stage 2**: if there is a significant increase in credit risk from initial recognition a financial asset is moved to Stage 2 and a lifetime ECL is recognised.
- **Stage 3**: when there is objective evidence of impairment and the financial asset is considered to be in default, it is moved to Stage 3 and a lifetime ECL is recognised.

A 12-month ECL is defined as the portion of lifetime ECL that will result if a default occurs in the 12-months after the reporting date, weighted by the probability of that default occurring.

A lifetime ECL is defined as ECLs that result from all possible default events over the expected behavioural life of a financial instrument.

For loan commitments, where the loan commitment relates to the undrawn component of a facility, it is assigned to the same stage as the drawn component of the facility. For pipeline loans, the loan commitment is assigned to Stage 1.

If the contractual cash flows on a financial asset have been renegotiated or modified and the financial asset was not derecognised, an assessment is made to consider whether there has been a significant increase in the credit risk of the financial instrument.

Significant increase in credit risk

The Bank applies a series of quantitative, qualitative and backstop criteria to determine if there has been a significant increase in credit risk:

- **Quantitative criteria**: this is based on a doubling of the probability of default plus 45bps since origination for the commercial and portfolio buy-to-let exposures and a deterioration in a customer's credit score of greater than or equal to 160 points for retail mortgages. The quantitative criteria for which our commercial, portfolio buy-to-let and retail mortgages are annually reviewed by our credit risk teams.
- **Qualitative criteria**: this includes the observation of specific events such as short-term forbearance, payment cancellation, historical arrears, or extension to customer terms.
- **Backstop criteria**: IFRS 9 includes a backstop that 30-days past due is an indicator of a significant increase in credit risk. The Bank considers 30-days past due to be an appropriate backstop measure and does not rebut this presumption.

Definition of default and credit-impaired assets

The Bank's definition of default is fully aligned with the definition of credit-impaired. The Bank applies both a qualitative and quantitative criterion to determine if an account meets the definition of default. These criteria include:

- When the borrower is more than 90-days past due; and
- Qualitative factors to comply with the internal rating systems risk grading approach adopted by the Bank.

Inputs into the assessment of whether a financial instrument is in default and their significance may vary over time to reflect changes in circumstances.

Presentation of loss allowances in the Balance Sheet

Loss allowances for financial assets measured at amortised cost are presented as a deduction from the gross carrying amount of the financial asset.

Write-offs

Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery.

Post model adjustments

At 30 September 2022, the Bank has recognised a post model adjustment in the financial statements to reflect the high inflation and higher interest rate environment. The adjustments to the Retail, Portfolio BTL and Commercial provisions reflect the lag in the current economic climate filtering through into lower credit scores / credit ratings for our customers which impact the probability of default used within the ECL provision calculations. In addition, a post model adjustment has been recognised to reflect the lag in the current economic climate filtering through to a reduction in residential property prices for the Bank's Retail portfolio. Further information is provided in note 14.

Hedge accounting

The Bank has elected to continue to apply the hedge accounting requirements of IAS 39. All derivatives entered into by the Bank are for the purposes of providing an economic hedge. Where the criteria set out in IAS 39 are met, the Bank uses hedge accounting and designates the hedging derivative as hedging fair value risks.

At inception of the hedge relationship, the Bank formally documents the relationship between the hedged item and the hedging instrument, including the nature of the risk, the risk management objective and strategy for undertaking the hedge and the method that will be used to assess the effectiveness of the hedging relationship at inception and on an ongoing basis.

At each hedge effectiveness assessment date, a hedge relationship must be expected to be highly effective on a prospective basis and demonstrate that it was effective (retrospective effectiveness) for the designated period in order to qualify for hedge accounting. A formal assessment is undertaken by comparing the hedging instrument's effectiveness in offsetting the changes in fair value or cash flows attributable to the hedged risk in the hedged item, both at inception and at each quarter end on an ongoing basis. A hedge is expected to be highly effective if the changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated were offset by the hedging instrument in a range of 80% to 125% and were expected to achieve such offset in future periods.

Hedge ineffectiveness is recognised in the Income Statement in other fair value gains and losses. For situations where the hedged item is a forecast transaction, the Bank also assesses whether the transaction is highly probable and presents an exposure to variations in cash flows that could ultimately affect the Income Statement.

Derivatives are primarily introduced into the portfolio at inception and therefore this prevents a large gain or loss on the hedged item as the derivative is introduced into the fair value macro hedge portfolio. Any gain or loss is amortised over the period to the date of maturity of the derivative. If a derivative no longer meets the criteria for hedge accounting, the cumulative fair value hedging adjustment is amortised over the period to maturity of the previously designated hedge relationship. If the underlying hedged item is sold or repaid, the unamortised fair value adjustment is recognised in the Income Statement.

Intangible assets

Where software costs are capitalised, they are amortised using the straight-line method over their estimated useful lives which is three to ten years. The amortisation periods used are reviewed annually. Costs associated with maintaining software are expensed as they are incurred. Amortisation is charged to its own line in the Income Statement.

Intangible assets have finite lives and are assessed for indicators of impairment at each Balance Sheet date.

An intangible asset is impaired where there is objective evidence that, as a result of one or more events that occurred after initial recognition, the estimated recoverable value of the asset has been reduced. The recoverable amount of the intangible assets is deemed to be its value in use. If there is objective evidence of impairment, an impairment loss is recognised in the Income Statement.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is provided on a straight-line basis over the anticipated useful lives as follows:

- Fixtures, fittings and equipment 3 - 10 years.

Investment properties – reversionary interests in properties

Reversionary interests in properties are included in the financial statements initially at cost and subsequently at fair value, with any change therein recognised in the Income Statement within other fair value gains and losses on investments.

The current market value of the underlying property is taken as the last formal valuation of the property on a vacant possession basis, modified by the change in the quarterly Nationwide Regional House Price Index, adjusted down by an annual underperformance assumption.

A further deduction is made from the value to reflect the expected sale expenses and a delay factor between death and sale of the property.

Investment properties are derecognised either when they have been disposed of, or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on derecognition are recognised in the Income Statement in the year of disposal within investment income.

Taxation including deferred tax

Corporation tax on profits for the year comprises current and deferred taxation.

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the Balance Sheet date. Where group relief is received or surrendered from or to a group company, the corresponding liability or asset is settled in full.

• Accounting policies (continued)

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements of the Bank.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised based on the latest strategic plan.

Deferred tax assets and liabilities are measured on a non-discounted basis at the tax rates that are expected to apply when the related asset is realised, or liability settled based on the tax rates and laws enacted or substantively enacted at the Balance Sheet date.

Deferred tax assets and liabilities are offset where there is a legally enforceable right to offset and where the deferred tax relate to income taxes levied by the same taxation authority and there is an intention to settle on a net basis.

Corporation tax is charged directly to the Income Statement.

Employee benefits

i) Pensions

The Bank has two pension schemes, a defined benefit scheme and a defined contribution scheme.

Defined Benefit Pension

The Bank operated a defined benefit pension scheme which is now closed to further accrual. The Bank participates in The Carlyle (1972) Pension and Life Assurance Scheme, a defined benefits scheme operated by The Carlyle Trust Limited. The assets of the scheme are held separately from those of the Bank.

The Bank's net obligation under the defined benefit pension scheme is assessed annually by an independent qualified actuary. The net obligation is calculated as the difference between the fair value of the scheme's assets and the amount of future entitlements earned by scheme members from service in the current and prior periods, discounted back to present values using a rate based on an index of long-dated AA rated corporate bonds using the projected unit method. This calculation allows the net obligation of the scheme to be expressed as either a surplus or deficit, which is recognised as either an asset or liability respectively in the Bank's accounts at the Balance Sheet date.

Defined Contribution Scheme

The Bank introduced a defined contribution scheme during the prior year, replacing the defined benefit scheme. A defined contribution scheme is one into which the Bank and the employee pay fixed contributions, without any obligation to pay further contributions. Payments into the defined contribution scheme are charged to the Income Statement as they become payable in accordance with the rules of the scheme.

ii) Reimbursement asset/ liability on pension deficit

The Bank has recognised a reimbursement liability to its parent company in respect of its pension scheme deficit which relates to retired employees that were contracted to the Bank's ultimate parent, The Carlyle Trust Limited (TCT) (note 24). The movement in the reimbursement asset / liability each year is recognised in the Income Statement to the extent that the reimbursement relates to a charge or a gain in the Bank's Income Statement. The defined benefit pension scheme liabilities are split between TCT and the Bank based on the split of scheme members by employer. The defined benefit pension scheme assets have been split in proportion to the scheme's liabilities at 30 September 2020, being the position prior to the disposal of the Hodge Life Assurance Company Limited. Any payments made into the scheme from this date are allocated to the assets of the employer making the payment. The reimbursement asset / liability represents the value of TCT's defined benefit pension scheme's assets less its share of the scheme's liabilities.

2. Judgement in applying accounting policies and critical accounting estimates

The Bank has to make judgements in applying its accounting policies which affect the amounts recognised in the financial statements of the Bank. In addition, estimates and assumptions are made that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The most significant areas where judgement and estimates are made are as follows:

An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Judgements

Fair values of financial instruments

The Bank uses widely recognised valuation models for determining the fair value of common and simple financial instruments, such as interest rate swaps that use only observable market data. Further analysis can be found in note 26.

The availability of observable market prices and model inputs reduces the need for management judgement 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.

Where observable market data is unavailable, unobservable inputs are used in the actuarial valuation models to value retirement mortgages held at FVTPL. The key judgements and assumptions used, and the related sensitivities are outlined in note 26.

Estimates and assumptions

Impairment losses on loans and advances to customers

IFRS 9 has a single impairment model that applies to all financial instruments in its scope. Under this model, an entity must recognise either a 12-month or lifetime expected credit loss. ECLs are the present value of all cash shortfalls over the expected life of the financial instrument. The key assumptions used, and the related sensitives, are outlined in note 27.

Value of reversionary investment properties

There is significant judgement applied in setting the assumptions used in calculating the fair value of reversionary interests in property. Further information on the following assumptions is provided in note 17.

- Property prices
- Mortality or entry into long term care
- Expense assumption
- Discount rate.

Pension scheme assumptions

Estimation uncertainty surrounds the measurement of the pension scheme liabilities. The assumptions used as part of the valuation include the rate of salary increase, the discount rate applied to scheme liabilities and inflation. The key assumptions used are disclosed in note 24.

Value of retirement mortgages including the value of the NNEG

There is significant judgement applied in setting the assumptions used in calculating the fair value of retirement mortgages and the liability arising from the no-negative equity guarantee. Further information on the following assumptions is provided in note 26(d).

- Mortality or entry into long term care
- Lapses
- Expense assumption
- Discount rate
- Property prices.

3. Segmental information

The Board is the Bank's chief operating decision-maker (CODM). Management has determined the operating segments based on information reviewed by the Board for the purposes of allocating resources and assessing performance.

Year ended 30 September 2022	Commercial £m	Retail £m	Portfolio Buy-to-Let £m	Other £m	Total £m
Interest receivable and similar income	11.5	33.2	2.8	3.0	50.5
Interest (payable)/receivable and similar charges	(4.8)	(19.3)	(1.7)	4.7	(21.1)
Fees and commissions receivable	0.1	1.9	-	0.6	2.6
Fees and commissions payable	-	-	-	(0.1)	(0.1)
Investment income	-	6.7	-	-	6.7
Other operating income	-	-	-	-	-
Administrative expenses	(6.1)	(22.1)	(1.7)	(4.3)	(34.2)
Depreciation and amortisation	-	(1.7)	-	(0.8)	(2.5)
Impairment gains/(losses) on loans and advances to customers	0.6	(0.2)	(0.4)	-	-
Bad debt recovery	0.4	-	-	-	0.4
Operating profit/(loss)	**1.7**	**(1.5)**	**(1.0)**	**3.1**	**2.3**

Year ended 30 September 2021	Commercial £m	Retail £m	Portfolio Buy-to-Let £m	Other £m	Total £m
Interest receivable and similar income	13.1	23.4	2.6	0.5	39.6
Interest payable and similar charges	(4.7)	(15.6)	(1.4)	(0.3)	(22.0)
Fees and commissions receivable	0.3	1.1	-	1.1	2.5
Investment income	-	6.0	-	-	6.0
Other operating income	-	-	-	0.1	0.1
Administrative expenses	(5.3)	(14.4)	(1.5)	(4.7)	(25.9)
Depreciation and amortisation	-	(0.9)	-	(1.5)	(2.4)
Impairment gains/(losses) on loans and advances to customers	0.2	(0.1)	(0.4)	-	(0.3)
Bad debt recovery	0.3	-	-	-	0.3
Operating profit/(loss)	**3.9**	**(0.5)**	**(0.7)**	**(4.8)**	**(2.1)**

Total assets by business segments	2022 £m	2021 £m
Commercial	182.2	233.9
Retail	1,198.6	852.3
Portfolio Buy-to-Let	76.5	70.5
Other	403.5	556.7
	1,860.8	**1,713.4**

4. Interest receivable and similar income

	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m
Interest income calculated using EIR method		
Loans and advances to customers	46.9	38.8
Loans and advances to credit institutions	1.6	0.3
Interest on government bonds & debt securities	2.0	0.5
	50.5	**39.6**

5. Interest payable and similar charges

	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m
On customer accounts	16.7	13.8
On defined benefit pension scheme (note 24)	0.3	0.3
On term funding scheme	1.9	0.1
On derivative financial instruments	2.2	7.8
	21.1	**22.0**

6. Administrative expenses

	Year ended 30 September 2022	Year ended 30 September 2021
Staff costs		
Wages and salaries	17.7	14.5
Social security	2.0	1.4
Pension costs – defined benefit scheme (note 24)	-	1.4
Pension costs – defined contribution scheme	1.8	0.8
Pension curtailment gain (note 24)	-	(0.7)
	21.5	**17.4**
Other administrative expenses	12.7	8.5
	34.2	**25.9**

Directors and employees

The average number of employees of the Bank during the period was as follows:

	Year ended 30 September 2022	Year ended 30 September 2021
Provision of finance and banking	354	321
	354	**321**

Staff costs include remuneration in respect of Directors as follows:

	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m
Fees	0.4	0.4
Aggregate emoluments as executives	1.0	0.6
	1.4	**1.0**

The emoluments of the highest paid director, excluding pension contributions, were as follows:

	Year ended 30 September 2022 £000	Year ended 30 September 2021 £000
Aggregate emoluments	418	240
	418	**240**

The pension accrued for the highest paid director was £2,609 (2021: £14,104).

No directors accrued benefits in the defined benefit scheme (2021: Two).

7. Other fair value gains

	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m
Movement in fair value of derivatives (note 22)	8.5	22.0
Movement in fair value of equity release and retirement mortgages	(1.2)	(11.5)
Reversal of unrealised gains on disposal of investment properties	(6.8)	(6.1)
Movement in fair value of investment properties (note 17)	1.3	6.6
Movement in fair value of derivatives held within an effective macro hedge relationship	61.1	1.3
Movement in fair value of hedged items attributable to hedged risk (notes 11, 12, 13 and 21)	(58.6)	(1.0)
	4.3	**11.3**

8. Profit on ordinary activities before taxation

	Year ended 30 September 2022 £000	Year ended 30 September 2021 £000
Profit on ordinary activities before taxation is stated after charging:		
Remuneration of the auditor and its associates		
Audit of the financial statements of the Bank		
- Current year	371	298
- Prior year	30	-
Non audit services	30	-
Amortisation (note 15)	2,010	1,855
Depreciation (note 16)	451	510

9. Tax charge/(credit) on profit

	Year ended 30 September 2022 £m	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m	Year ended 30 September 2021 £m
Analysis of charge in the financial period				
UK corporation tax				
Current tax on income for the year	(1.0)		(0.1)	
Prior period adjustment	(0.2)		-	
Total current tax		**(1.2)**		**(0.1)**
Deferred tax				
Origination/reversal of timing differences:				
Current period	2.9		1.4	
Prior period adjustment	0.1		(0.4)	
Effect of tax rate change on opening balance	-		(3.0)	
Total deferred tax (note 18)		**3.0**		**(2.0)**
Tax charge/(credit) on profit on ordinary activities		**1.8**		**(2.1)**

The total tax charge for the period is higher than 19% (2021: lower than 19%) the blended rate of corporation tax in the UK. The differences are explained below.

	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m
Total tax reconciliation		
Profit on ordinary activities before tax	6.6	3.7
Current tax at 19.00% (2021: 19.00%)	**1.3**	**0.7**
Expenses not deductible for tax purposes	-	0.6
Effect of deferred tax unwinding at the current tax rate	0.6	-
Effect of tax rate change on opening balance	-	(3.0)
Adjustments in respect of previous years	(0.1)	(0.4)
Total tax charge/(credit)	**1.8**	**(2.1)**

In the prior period the UK government announced that from 1 April 2023 the corporation tax rate will increase from 19% to 25%. The closing deferred tax assets and liabilities have been calculated at 25%.

	Year ended 30 September 2022 £m	Year ended 30 September 2021 £m
Tax relating to other comprehensive income		
Temporary difference in relation to the defined benefit pension scheme	2.2	0.4
Temporary difference in relation to the pension reimbursement liability	-	(0.6)
Tax charge / (credit) relating to other comprehensive income	**2.2**	**(0.2)**

10. Loans and advances to credit institutions

	2022 £m	2021 £m
Repayable on demand	0.2	23.4
Collateral held by swap counterparties	-	22.5
Total asset	**0.2**	**45.9**

The collateral is pledged against the market value of derivative instruments and comprises interest-bearing cash deposits (note 22). Collateral that has been pledged and held is not restricted and is returned at the end of the contract. There are no provisions held in respect of loans and advances to credit institutions (2021: £nil).

11. Government bonds

	2022 £m	2021 £m
Government bonds – at amortised cost	114.5	29.8
Fair value adjustment for hedged risk	(3.3)	-
	111.2	**29.8**

The movement in government bonds is summarised as follows:

	2022 £m	2021 £m
At start of year	29.8	48.6
Additions	118.9	-
Redemptions and interest received	(34.0)	(18.1)
Loss from hedge accounting – Income Statement	(3.3)	-
Premium unwind	(0.2)	(0.7)
At end of financial year	**111.2**	**29.8**

12. Debt securities

	2022 £m	2021 £m
Debt securities – at amortised cost	119.8	42.3
Fair value adjustment for hedged risk	(3.6)	-
	116.2	**42.3**

The movement in debt securities is summarised as follows:

	2022 £m	2021 £m
At start of year	42.3	50.7
Additions	83.5	-
Redemptions and interest received	(6.6)	(8.3)
Loss from hedge accounting - Income Statement	(3.6)	(0.1)
Discount unwind	0.6	-
At end of financial year	**116.2**	**42.3**

13. Loans and advances to customers

	2022 £m	2021 £m
Loans and advances – classified at amortised cost		
Commercial	182.2	233.9
Retail	1,140.0	679.0
Portfolio Buy-to-Let	76.5	70.5
	1,398.7	**983.4**
Amounts owed from parent and fellow subsidiaries	-	0.4
Fair value adjustment for hedged risk	(52.7)	(1.0)
Loans and advances (retirement mortgages) – classified as FVTPL - see note 26	58.6	78.7
	1,404.6	**1,061.5**

Of this amount, at 30th September 2022 £334.4m (2021: £190.4m) has been pledged as collateral under the TFSME. Collateral that has been pledged is restricted.

The amounts owed from parent is a loan due from The Carlyle Trust Limited and accrues a market rate of interest.

	2022 £m	2021 £m
Loans and advances to customers at amortised cost		
Gross balances	1,403.6	989.9
Less: Provision for impairment	(8.6)	(8.4)
Less: Net loan fee deferral	3.7	1.9
Net balance	**1,398.7**	**983.4**

14. Impairment provisions on loans and advances to customers

IFRS 9	Stage 1 £m	Stage 2 £m	Stage 3 £m	Post Model Adjustment £m	Total £m
2022					
At start of year	1.3	2.0	5.1	-	8.4
Utilised in year	-	-	-	-	-
Income Statement					
Impairment (gains)/losses	0.4	(0.7)	(0.5)	0.8	-
Interest reduction for credit-impaired financial assets	-	-	0.2	-	0.2
At 30 September 2022	**1.7**	**1.3**	**4.8**	**0.8**	**8.6**

During the year, the Bank has recovered £0.4m (2021: £0.3m) on a bad debt previously written off.

IFRS 9	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
2021				
At start of year	1.5	1.6	4.8	7.9
Utilised in the year	-	-	-	-
Income Statement				
Impairment (gains)/losses	(0.2)	0.4	0.1	0.3
Interest reduction for credit-impaired financial assets	-	-	0.2	0.2
At 30 September 2021	**1.3**	**2.0**	**5.1**	**8.4**

The impact of modifications to contractual cash flows that has not resulted in derecognition is immaterial in the year.

For further details on loans and advances to customers refer to note 27.

• Impairment provisions on loans and advances to customers (continued)

Post model adjustments

At 30 September 2022, the Bank has recognised a post model adjustment in the financial statements to reflect the high inflation and higher interest rate environment. The adjustments to the Retail, Portfolio BTL and Commercial provisions reflect the lag in the current economic climate filtering through into lower credit scores / credit ratings for our customers which impact the probability of default used within the ECL provision calculations. In addition, a post model adjustment has been recognised to reflect the lag in the current economic climate filtering through to a reduction in residential property prices for the Bank's Retail portfolio. The anticipated fall in commercial and residential property prices for Commercial and Portfolio BTL has been reflected within the underlying ECL models for these portfolios. The following table provides a breakdown of the post model adjustment:

Post Model Adjustments	2022 £m	2021 £m
Retail – inflation and higher interest rates	0.1	-
Retail – 10% reduction in residential property prices	0.1	-
Portfolio Buy-to-Let – inflation and higher interest rates	0.2	-
Commercial – inflation and higher interest rates	0.4	-
	0.8	**-**

The post model adjustment for inflation and higher interest rates has been determined by identifying customers that are deemed to be most at risk of default in the next 12 months, by considering the customers' credit scores, indebtedness and income. For the customers identified as highest risk, the PD has been increased by decreasing the customers' credit scores by 160pts for Retail customers and decreasing the credit ratings by two grades for both Commercial and Portfolio Buy-to-Let. This has also resulted in some customers moving from Stage 1 to Stage 2 and Stage 2 to Stage 3 where a lifetime PD is used within the ECL calculation.

The post model adjustment provision will be utilised once the lag in the current economic climate has filtered through to the customers' credit scores, credit ratings and property prices.

15. Intangible assets

	Computer software	
	2022 £m	2021 £m
Cost:		
At start of year	12.0	10.1
Additions	4.3	1.9
At end of financial year	**16.3**	**12.0**
Amortisation:		
At start of year	(4.6)	(2.8)
Amortisation	(2.0)	(1.8)
At end of financial year	**(6.6)**	**(4.6)**
Net book value:		
At end of financial year	**9.7**	**7.4**

£1.1m (2021: £1.5m) of expenditure relating to intangible projects was expensed during the year as it did not meet the development criteria of IAS 38 and has therefore been expensed as incurred.

16. Property, plant and equipment

	Fixtures, fittings and equipment	
	2022 £m	2021 £m
Cost:		
At start of year	2.9	3.5
Additions	0.4	0.2
Disposals	-	(0.8)
At 30 September	**3.3**	**2.9**
Depreciation:		
At start of year	(1.3)	(1.6)
Depreciation	(0.5)	(0.5)
Disposals	-	0.8
At 30 September	**(1.8)**	**(1.3)**
Net book value:		
At 30 September	**1.5**	**1.6**

17. Investment properties

	Reversionary Interests £m
At start of year	94.6
Portfolio disposal	(76.7)
Disposals	(10.0)
Fair value adjustments	1.3
At 30 September 2022	**9.2**

The historical cost of the reversionary interest in properties is £2.5m at 30 September 2022 (2021: £38.1m).

On 13 April 2022, the Bank sold a portfolio of 613 reversion properties to Hodge Reversions Limited, a fellow subsidiary company for £76.6m. A further property was sold on 14 June 2022 for £0.1m. No gain or loss was recognised on disposal.

Reversionary interests are categorised as Level 3 in the fair value hierarchy. There were no transfers into or out of Level 3 in the year.

Reversionary interests - principal assumptions

All gains and losses arising from reversionary interests are largely dependent on the longevity of the tenant. Principal assumptions underlying the calculation of reversionary interests include the following:

Mortality or entry into long term care

This is based on the expected death or entry into long term care of the tenant or the last remaining tenant in relation to a joint contract. Mortality assumptions have been derived by reference to the PCMA00/PCFA00 mortality tables and include an allowance for mortality improvements. This table is adjusted from 1 January 2000 to 1 January 2019 for mortality improvements based on the CMI 2017 mortality projection model. The table is adjusted for Mortality improvements after this date using the CMI 2018 model. Finally, the mortality tables are further adjusted to reflect recent mortality experience by multiplying the mortality rates by a percentage factor. Given that CMI 2018, 2019, 2020 and 2021 produce similar life expectancies, the mortality improvement assumptions for the 2022 year end are unchanged.

Early redemptions are expected to be very infrequent, and therefore the voluntary redemptions rate is included in the mortality assumption.

Expenses

Assumptions for future policy expense levels are based on the Bank's recent expense analysis. Expenses are modelled as an amount per policy per annum that incorporates an annual inflation rate allowance of 4.85% p.a. as at 30 September 2022 (2021: 4.59% p.a.). This rate is equal to the market implied rate of RPI inflation (appropriate for the average duration of the reversion portfolio) plus an allowance for expenses increasing faster than the market expectation of prices.

Discount rate

The discount rate applied to the reversion cash flows comprises two parts: a risk-free yield curve plus a spread referred to as the illiquidity spread.

The risk-free yield curve is based on the PRA's Solvency II curve methodology, which uses SONIA swap rates. An internal tool developed by Milliman is used to derive the expected PRA curve for use in each month's valuation; this is then validated against the actual PRA curve when it is published.

The average discount rate for the portfolio (assumed to be the 5-year point (2021: 8-year point) on the yield curve based on the expected average duration) at 30 September 2022 was 7.2% (2021: 3.03%) - including an illiquidity spread of 2.17% (2021: 2.17%).

Property prices

The value of a property is based on the value at the last survey increased to the current valuation date using the Nationwide Regional House Price Index. This is then adjusted down by a 10% haircut to reflect the expectation that property prices underperform the house price index due to the older age of the policyholders and a disincentive to maintain the property when it is subject to a reversion. For properties that have been subject to a physical or drive-by valuation, the 10% haircut will not be applied as these valuations will already reflect the condition of the property. No future property price inflation is assumed beyond the valuation date.

Sensitivity analysis

Changes to unobservable inputs used in the valuation technique could give rise to significant changes in the fair value of the assets. The Bank has estimated the net decrease in profit before tax for the period arising from changes to these inputs as follows:

	Reversionary Interests			
	Delay in mortality or entry into long term care - 10% £m	Discount rate +1% £m	Expenses +10% £m	Property prices -10% £m
At 30 September 2022	-	-	-	(0.9)
At 30 September 2021	(1.5)	(5.3)	(0.4)	(8.6)

The sensitivity factors are applied via actuarial models. The analysis has been prepared for a change in each variable with other assumptions remaining constant. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear and larger or smaller impacts cannot be interpolated or extrapolated from these results.

18. Deferred tax

	2022 £m	2021 £m
At start of year	11.5	9.5
(Charge)/Credit to the Income Statement – current period	(2.9)	1.4
(Charge)/Credit to the Income Statement – prior period	(0.1)	0.4
Credit to the Statement of Other Comprehensive Income – reimbursement asset	-	0.6
Charge to the Statement of Other Comprehensive Income – defined benefit pension scheme	(2.2)	(0.4)
At end of financial year	**6.3**	**11.5**

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

	2022 £m	2021 £m
Accelerated capital allowances	(0.4)	(0.5)
Other timing differences	3.6	4.5
Timing differences on reimbursement asset	-	-
Defined benefit pension scheme	1.2	3.6
Tax losses	1.9	3.9
At end of financial year	**6.3**	**11.5**

19. Other assets

	2022 £m	2021 £m
Prepayments and accrued income	3.4	2.6
Corporation tax debtor	-	0.8
Group relief debtor	1.0	0.1
Other assets	3.6	3.1
At end of financial year	**8.0**	**6.6**

20. Deposits from banks

	2022 £m	2021 £m
Term Funding Scheme	205.0	145.0
Collateral held on behalf of swap counterparties	16.0	-
	221.0	**145.0**

21. Deposits from customers

	2022 £m	2021 £m
Deposit from customers	1,413.9	1,248.5
Amounts owed to parent and fellow subsidiaries	11.3	132.7
Fair value adjustment for hedged risk	(0.2)	(0.2)
	1,425.0	**1,381.0**

The amounts owed to parent and fellow subsidiaries are deposit accounts which accrue a market rate of interest.

22. Derivative financial instruments

Interest rate swaps are used by the Bank for hedging purposes. These are commitments to exchange one set of cash flows for another.

No exchange of principal takes place.

	Contract/notional amount 2022 £m	Fair value 2022 £m
Derivative assets		
Interest rate swaps held at fair value	138.2	11.1
Derivatives held in fair value hedges	507.1	64.7
Total recognised derivative assets	**645.3**	**75.8**
Derivative liabilities:		
Interest rate swaps held at fair value	85.7	(11.4)
Total recognised derivative position	**731.0**	**64.4**

	Contract/notional amount 2021 £m	Fair value 2021 £m
Derivative liabilities held:		
Interest rate swaps held at fair value	155.2	(15.8)
Derivatives held in fair value hedges	164.0	1.1
Total recognised derivative liabilities	**319.2**	**(14.7)**

At 30 September 2022, the fixed interest rates vary from 0.0% to 4.0% (2021: 0.0% to 4.9%), the floating rates are SONIA (2021: LIBOR).

Gains and losses recognised on interest rate swap contracts are credited to the Income Statement.

Hedge Accounting

The following table describes the types of derivatives used, the related risks and the activities against which the derivative financial instruments are used to hedge.

Type of Hedge	Risk	Activity
Interest rate swap	Sensitivity to changes in interest rates	Fixed rate savings products, Fixed rate retail mortgages, Fixed rate debt securities, Fixed rate government bonds and Fixed rate commercial loans.

The amounts relating to items designated as hedged items were as follows:

	2022 Book Value £m	2022 Hedged Items £m	2022 Hedged Fair Value £m	2021 Book Value £m	2021 Hedged Items £m	2021 Hedged Fair Value £m
Hedged Assets						
Government bonds	111.2	32.4	(5.3)	29.8	-	-
Debt securities	116.2	29.9	(3.7)	42.3	3.5	-
Loans advances to customers	1,398.7	439.6	(52.9)	983.4	78.1	(1.0)
Hedged Liabilities						
Customer deposits	-	-	-	(1,248.4)	(69.3)	0.2
	1,626.1	**501.9**	**(61.9)**	**(192.9)**	**12.3**	**(0.8)**

• Derivative financial instruments (continued)

At 30 September 2022, the hedge ineffectiveness on the hedged asset portfolio amounted to £2.7m (2021: £0.2m). A hedge ineffectiveness gain of £2.5m has been recognised within the Income Statement in the year ended 30 September 2022 (2021: £nil).

The immaterial hedge liability portfolio was ineffective at 30 September 2022 and therefore the hedge accounting for this portfolio has been discontinued from the date that the portfolio was last effective. The hedge ineffectiveness on the hedged liability portfolio at 30 September 2021 amounted to £0.1m. The cumulative unamortised fair value adjustment for hedges that have been discontinued at 30 September 2022 amounts to £0.2m (2021: £nil).

Possible sources of ineffectiveness include differences between the expected and actual volumes of prepayments, difference in the discounting between the hedged item and the hedging instrument and derivatives with a non-zero fair value at the date of initial designation as a hedging instrument.

Fair Value

The Bank also holds a portfolio of derivatives held at fair value which are held for the purposes of managing the interest rate risk on the Group's reversionary asset portfolio.

	2022 £m	2021 £m
Movement in fair value of interest rate swaps	8.5	22.0
	8.5	**22.0**

The Bank agreed to exit a number of interest rate swaps during the year which were held at fair value of £8.6m (2021: £45.0m), £Nil (2021: £0.3m) profit or loss was incurred on disposal.

Offsetting

In accordance with IAS32 Financial Instruments; the Bank reports derivative financial instruments on a net basis as there is a legally enforceable right to set-off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. A table is provided below which demonstrates the amounts which have been offset in the Balance Sheet:

	Amounts subject to netting arrangements		
	Gross amounts £m	Amounts offset £m	Net amounts reported on Balance Sheet £m
2022			
Derivative financial assets	76.1	(0.3)	75.8
Impact on total assets	**76.1**	**(0.3)**	**75.8**
Derivative financial liabilities	(11.7)	0.3	(11.4)
Impact on total liabilities	**(11.7)**	**0.3**	**(11.4)**
2021			
Derivative financial assets	2.3	(2.3)	-
Impact on total assets	**2.3**	**(2.3)**	**-**
Derivative financial liabilities	(17.0)	2.3	(14.7)
Impact on total liabilities	**(17.0)**	**2.3**	**(14.7)**

23. Other liabilities

	2022 £m	2021 £m
Due within one year:		
Amounts owed in relation to mortgages administered for third parties	4.9	6.1
Other creditors	0.5	0.3
Other taxation and social security	0.3	0.5
Pension reimbursement liability	0.2	-
Accruals	4.6	3.0
Amounts owed to fellow subsidiaries	3.4	-
	13.9	**9.9**

The amounts owed to fellow subsidiaries are repayable on demand and accrue no interest.

24. Pension scheme

The Carlyle Trust Limited group operated a defined benefit pension scheme for certain Directors and employees, The Carlyle (1972) Pension and Life Assurance Scheme. The scheme was closed to future accrual with effect from April 2021.

The assets of the scheme are administered by the Trustees and are held in a fund that is separate and independent of other group funds. The scheme was established with effect from 1972 and is fully approved under Chapter I Part XIV of the Income and Corporation Taxes Act 1988.

The scheme is subject to the funding legislation outlined in the Pensions Act 2004. This, together with documents issued by the Pensions Regulator, and Guidance Notes adopted by the Financial Reporting Council, sets out the framework for funding defined benefit occupational pension schemes in the UK.

The scheme typically exposes the Bank to actuarial risks such as investment risk, interest rate risk, mortality risk and longevity risk. A decrease in corporate bond yields, a rise in inflation or an increase in life expectancy would result in an increase to plan liabilities. This would detrimentally impact the Balance Sheet and may give rise to increased charges in future periods. The Bank has not changed its processes used to manage its risks from previous periods.

The weighted average duration of the defined pension obligation is 23 years (2021: 24 years).

Pension costs are assessed in accordance with the advice of a qualified, independent actuary using the projected unit method. The assumptions which have the most significant effect on the calculation are the long-term average investment return expected in future and the rate of future increases to benefits, both before and after retirement.

The calculations are based upon an assessment of the scheme's liabilities as at 30 September 2022. These have been based upon the results of the 1 April 2019 formal triennial valuation projected forward with allowance for benefit accrual and expected investment return. The next triennial valuation is being caried out as at 1 April 2022.

The Bank's total expense for the year amounted to £0.4m (2021: £1.1m). The Bank has agreed that it will aim to eliminate the pension scheme deficit over the next 6 years and additional contributions of £1.2m (2021: £1.6m) were paid into the scheme in the year ended 30 September 2022.

The IAS 19 valuation as at 30 September 2022 has been produced by a qualified independent actuary and is based on the results of the valuation as at 1 April 2019.

Scheme assets and liabilities

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain, were:

	2022 £m	2021 £m
Fair value of plan assets	25.5	37.9
Present value of defined benefit obligations	(30.0)	(52.1)
Deficit	**(4.5)**	**(14.2)**

Movements in fair value of plan assets

	2022 £m	2021 £m
Market value of assets at the beginning of the year	37.9	30.3
Interest income	0.8	0.5
Actuarial (loss)/gain	(12.9)	2.7
Member contributions	-	0.3
Employer contributions	1.2	5.2
Benefits paid	(1.5)	(1.1)
Market value of assets at the end of the year	**25.5**	**37.9**

Movements in present value of defined benefit obligations

	2022 £m	2021 £m
Present value of scheme liabilities at the beginning of the year	52.1	51.3
Interest cost	1.1	0.8
Current service cost	-	1.4
Member contributions	-	0.3
Actuarial (gain)/loss on defined benefit obligation of which:		
due to experience	1.5	(0.3)
due to financial assumptions	(23.2)	0.4
Benefits paid	(1.5)	(1.1)
Curtailments	-	(0.7)
Present value of scheme liabilities at end of the year	**30.0**	**52.1**

• Pension scheme (continued)

Expense recognised in the Income Statement

	2022 £m	2021 £m
Current service cost – staff costs	-	1.4
Net interest expense – other finance costs	0.3	0.3
Curtailment gain	-	(0.7)
Other admin costs	0.1	0.1
	0.4	**1.1**

The total amount recognised in the Statement of Other Comprehensive Income in respect of actuarial gains and losses is a gain of £9.0m (2021: gain of £2.6m) before tax.

Cumulative losses reported in the Statement of Other Comprehensive Income since the date of transition to FRS 101 are losses of £3.3m (2021: losses of £10.7m) after deferred tax.

A curtailment gain of £Nil (2021:£0.7m) was recognised in the Income Statement as a result of the closure in April 2021 of the defined benefit scheme to further accrual.

Plan assets

The fair value of the plan assets and the return on those assets was as follows:

	2022 £m	2021 £m
Quoted equity investments	4.6	7.2
Diversified growth funds	6.1	7.6
Private investments	4.6	5.7
Bonds	3.8	7.6
LDI	6.1	8.7
Cash	0.3	1.1
Total market value of assets	**25.5**	**37.9**

The actual return on assets was a loss of £12.1m (2021: gain £3.2m).

Future contributions

The Bank expects to contribute approximately £1.6m to its defined benefit plan in the next financial year.

Major assumptions

The major assumptions underpinning the defined benefit obligation are:

	2022 %	2021 %
Rate of increase for pensions in payment – RPI capped at 5.0% per annum	3.8	3.4
Discount rate applied to scheme liabilities	5.1	2.1
RPI inflation assumption	4.0	3.5

The assumptions relating to longevity underlying the pension liabilities at the Balance Sheet date are based on standard actuarial mortality tables and include an allowance for future improvements in longevity. The life expectancy of scheme members is as follows:

	2022	2021
Current pensioners age 65 – male	86.8	86.8
Current pensioners age 65 – female	89.2	89.1
Future pensioners age 65 (current age 45) - males	87.8	87.8
Future pensioners age 65 (current age 45) - females	90.3	90.3

Sensitivities

The Bank has to make assumptions on the discount rate, inflation and life expectancy when valuing the pension scheme liability. The sensitivity of the defined pension obligation to changes in the weighted principal assumptions is:

Impact on present value of obligation:	Change in assumption	Change in deficit £m
Discount rate	0.1%	0.6
Rate of inflation (RPI or CPI)	0.1%	0.3
Life expectancy	1 year	0.7

The sensitivity analyses above have been determined based on a method that extrapolates the impact on the defined benefit obligation as a result of reasonable changes in key assumptions occurring at the end of the reporting period. The sensitivity analyses are based on a change in a significant assumption, keeping all other assumptions constant. The sensitivity analyses may not be representative of an actual change in the defined benefit obligation as it is unlikely that changes in assumptions would occur in isolation of one another.

• Pension scheme (continued)

History of the scheme Balance Sheet position

	2022 £m	2021 £m	2020 £m	2019 £m	2018 £m
Fair value of plan assets	25.5	37.9	30.3	27.3	24.2
Present value of funded defined benefit obligations	(30.0)	(52.1)	(51.3)	(43.9)	(37.0)
Deficit	**(4.5)**	**(14.2)**	**(21.0)**	**(16.6)**	**(12.8)**

History of experience gains and losses

	2022	2021	2020	2019	2018
Difference between the expected and actual return on scheme assets:					
Amount	**£(12.9)m**	£2.7m	£(0.4)m	£0.6m	£(1.4)m
Percentage of year-end scheme assets	**(50.6)%**	7.1%	(1.3)%	2.2%	(5.6)%
Experience gains and losses on scheme liabilities:					
Amount	**£1.5m**	£(0.3)m	£(0.0)	£(1.9)m	£(0.0)m
Percentage of year-end present value of scheme liabilities	**5.0%**	(0.6)%	0.0%	(4.4)%	0.0%
Total amount recognised in statement of comprehensive income:					
Gain/(loss) before tax	**£9.0m**	£2.6m	£(4.4)m	£(3.3)m	£0.6m
Percentage of year-end present value of scheme liabilities	**30.0%**	5.0%	(8.5)%	(7.5)%	1.6%

25. Called up share capital

	2022 £m	2021 £m
Authorised, allotted, called-up and fully paid:		
130,000,000 (2021:105,000,000) ordinary shares of £1 each	130.0	105.0
	130.0	**105.0**

On 22 June 2022, 25,000,000 ordinary shares of £1 each were allotted at par.

26. Financial instruments

a) Categories of financial assets and liabilities

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

The accounting policies note describes how the classes of financial instruments are measured and how income and expenses including fair value gains and losses, are recognised. The following tables analyse the financial assets and liabilities in the Balance Sheet by the class of financial instrument to which they are assigned and by the measurement basis and include both non-financial assets and liabilities in order to reconcile the disclosures to Balance Sheet totals.

As at 30 September 2022	At amortised cost £m	FVTPL £m	Total £m
Assets			
Cash and balances held at central banks	118.1	-	118.1
Loans and advances to credit institutions	0.2	-	0.2
Derivative financial instruments	-	75.8	75.8
Government bonds	111.2	-	111.2
Debt securities	116.2	-	116.2
Loans and advances to customers	1,346.0	58.6	1,404.6
Other assets	8.0	-	8.0
Total financial assets	**1,699.7**	**134.4**	**1,834.1**
Total non-financial assets	17.5	9.2	26.7
Total assets	**1,717.2**	**143.6**	**1,860.8**
Liabilities			
Deposit from banks	221.0	-	221.0
Deposit from customers	1,425.0	-	1,425.0
Derivative financial instruments	-	11.4	11.4
Other liabilities	13.9	-	13.9
Total financial liabilities	**1,659.9**	**11.4**	**1,671.3**
Total non-financial liabilities	4.5	-	4.5
Share capital and other reserves	185.0	-	185.0
Total reserves and liabilities	**1,849.4**	**11.4**	**1860.8**

As at 30 September 2021	At amortised cost £m	FVTPL £m	Total £m
Assets			
Cash and balances held at central banks	412.2	-	412.2
Loans and advances to credit institutions	45.9	-	45.9
Government bonds	29.8	-	29.8
Debt securities	42.3	-	42.3
Loans and advances to customers	982.8	78.7	1,061.5
Other assets	6.6	-	6.6
Total financial assets	**1,519.6**	**78.7**	**1,598.3**
Total non-financial assets	20.5	94.6	115.1
Total assets	**1,540.1**	**173.3**	**1,713.4**
Liabilities			
Deposit from banks	145.0	-	145.0
Deposit from customers	1,381.0	-	1,381.0
Derivative financial instruments	-	14.7	14.7
Other liabilities	9.9	-	9.9
Total financial liabilities	**1,535.9**	**14.7**	**1,550.6**
Total non-financial liabilities	14.2	-	14.2
Share capital and other reserves	148.6	-	148.6
Total reserves and liabilities	**1,698.7**	**14.7**	**1,713.4**

• Financial instruments (continued)

b) Fair value estimation

The table below summarises the fair value of the Bank's financial assets and liabilities. The different levels have been defined as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Valuation techniques for which all significant inputs are based on observable market data.
- Level 3: Valuation techniques for which significant inputs are not based on observable market data.

Where applicable, the Bank 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 take place with sufficient frequency and volume to provide pricing information on an on-going basis. For all other financial instruments, the Bank determines fair value using other valuation techniques.

The fair value of financial assets and liabilities carried at amortised cost approximate to their carrying value on the Balance Sheet.

The following table presents the Bank's financial assets and liabilities that are measured at fair value on the face of the Balance Sheet and the disaggregation by fair value hierarchy and product type:

As at 30 September 2022	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Loans and advances to customers	-	-	58.6	58.6
Derivative financial instruments	-	75.8	-	75.8
Total financial assets at FVTPL	**-**	**75.8**	**58.6**	**134.4**
Financial liabilities at fair value through profit or loss				
Derivative financial instruments	-	11.4	-	11.4
Total financial liabilities at FVTPL	**-**	**11.4**	**-**	**11.4**

As at 30 September 2021	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets at fair value through profit or loss				
Loans and advances to customers	-	-	78.7	78.7
Total financial assets at FVTPL	**-**	**-**	**78.7**	**78.7**
Financial liabilities at fair value through profit or loss				
Derivative financial instruments	-	14.7	-	14.7
Total financial liabilities at FVTPL	**-**	**14.7**	**-**	**14.7**

c) Level 1 and 2 assets and liabilities measured at fair value

Derivative financial instruments:
Derivative products (interest rate swaps) use a valuation technique with observable market inputs, their fair value is based on counterparty valuations. Those valuations are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

The fair value of financial instruments that are not traded in an active market (for example, over the counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

Transfers
There were no transfers between Levels 1 and 2 during the year.

d) Level 3 assets and liabilities measured at fair value

Loans and advances to customers – retirement mortgages:
Loans and advances to customers include £58.6m (2021: £78.7m) of assets which have been classed as FVTPL and include retirement mortgages.

	Fair Value 2022 £m	Fair Value 2021 £m	Book Value 2022 £m	Book Value 2021 £m
Loans and advances (retirement mortgages) – classified as FVTPL	58.6	78.7	58.9	77.7
	58.6	**78.7**	**58.9**	**77.7**

Reconciliation of the opening and closing recorded amount of Level 3 loans secured by equity release and retirement mortgages:

	2022 £m	2021 £m
At start of year	78.7	226.8
Disposal of equity release portfolio to a third party	-	(112.1)
Loss on disposal	-	(5.5)
Fair value losses in the Income Statement	(1.2)	(3.9)
Loans advanced	0.2	0.6
Transfer to amortised cost	(1.2)	-
Redemptions	(17.9)	(27.2)
At end of financial year	**58.6**	**78.7**

The 9-year point on the risk free yield curve plus illiquidity spread used for discounting the future retirement mortgage cash flows has increased from 0.89% plus a 2.44% illiquidity spread to 4.43% plus a 2.44% illiquidity spread. The 9-year point reflects the current duration of the retirement mortgage portfolio.

• Financial instruments (continued)

d) Level 3 assets and liabilities measured at fair value (continued)

Retirement mortgages - principal assumptions

Principal assumptions in the calculation of retirement mortgages include:

Mortality or entry into long term care.

This is based on the expected death or entry into long term care of the tenant or the last remaining tenant in relation to a joint contract. Mortality assumptions have been derived by reference to the PCMA00/PCFA00 mortality tables and include an allowance for mortality improvements. This table is adjusted from 1 January 2000 to 1 January 2019 for mortality improvements based on the CMI 2017 mortality projection model. The table is adjusted for mortality improvements after this date using the CMI 2018 model. Finally, the mortality tables are further adjusted to reflect recent mortality experience by multiplying the mortality rates by a percentage factor. Given that CMI 2018, 2019, 2020 and 2021 produce similar life expectancies, the mortality improvement assumptions for the 2022 year end are unchanged.

Lapses

The fair value for retirement mortgages is materially insensitive to the choice of early redemption assumption. Due to limited market information, this assumption is derived from the Bank's own experience on this product.

Expenses

Assumptions for future policy expense levels are based on the Bank's recent experience analyses. Expenses are modelled as an amount per policy per annum that incorporates an annual inflation rate allowance of 4.85% p.a. as at 30 September 2022 (2021: 4.58% p.a.). This rate is equal to the market implied rate of RPI inflation (appropriate for the average duration of the retirement mortgage portfolio) plus an allowance for expenses increasing faster than the market expectation of prices.

Interest rate

The interest rate used to value the retirement mortgage portfolio comprises two parts: a risk-free yield curve plus a spread referred to as the illiquidity spread.

The risk-free yield curve is based on the PRA's Solvency II curve methodology, which uses SONIA swap rates. An internal tool developed by Milliman is used to derive a proxy for the PRA curve; this is then validated against the actual PRA curve when it is published.

The average discount rate for the portfolio (assumed to be the 9-year point (2021:15-year point) on the yield curve based on the average duration of our business) at 30 September 2022 was 6.87% p.a. (2021: 3.33%) - including an illiquidity spread of 2.44% (2021: 2.44% p.a.).

No-negative equity guarantee

The fair value of loans secured by retirement mortgages takes into account an explicit provision in respect of the no-negative equity guarantee, calculated using a variant of the Black Scholes option pricing model. The key assumptions used to derive the value of the no-negative equity guarantee include property growth, volatility and credit risk.

The current property price is based on the last survey valuation adjusted by the Nationwide Regional House Price Index with an annual underperformance assumption. The future property price is based on a Future HPI assumption with an annual underperformance assumption.

The property growth (net of underperformance) and volatility assumed at 30 September 2022 was 3.57% (2021:3.71%) and 15% (2021:15.0%) respectively.

The value of the no-negative equity guarantee as at 30 September 2022 is £0.1m (2021:£0.1m).

Sensitivity analysis

Changes to unobservable inputs used in the valuation technique could give rise to significant changes in the fair value of the assets. The Bank has estimated the net decrease in profit before tax for the period arising from changes to these inputs as follows:

	Interest rates +100 BP £m	Maintenance expenses +10% £m	Property inflation -100bps £m	Property prices -10% £m	Lapses +10% £m	Delay in mortality +10% £m
30 September 2022	**(0.2)**	**(0.2)**	**(0.1)**	**-**	**-**	**-**
30 September 2021	(0.5)	(0.4)	(0.1)	(0.1)	-	-

The sensitivity factors are applied via actuarial models. The analysis has been prepared for a change in each variable with other assumptions remaining constant. In reality, such an occurrence is unlikely due to correlation between the assumptions and other factors. It should also be noted that these sensitivities are non-linear and larger or smaller impacts cannot be interpolated or extrapolated from these results. These sensitivities are chosen as they are all key components of the fair value calculation. The sensitivity factors take into consideration that the Bank's assets and liabilities are actively managed and may vary at the time that any actual market movement occurs. In addition, swaps taken out will mitigate some of these sensitivities to movements in rates disclosed above.

e) Maturity profile of financial assets and liabilities

The table below analyses the carrying value of financial assets and liabilities into relevant maturity grouping based on the remaining period to the contractual maturity date. In practice, customer deposits will be repaid later than on the earliest date on which repayment can be required. Likewise, in practice, customer assets may be repaid ahead of their contractual maturity. As such, the Bank uses past performance of each asset and liability class along with management judgement to forecast likely cash flow requirements.

As at 30 September 2022	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Assets						
Cash and balances held at central banks	118.1	-	-	-	-	118.1
Loans and advances to credit institutions	0.2	-	-	-	-	0.2
Derivative financial instruments	(0.2)	-	-	61.9	14.1	75.8
Government bonds	24.2	14.5	44.1	-	28.4	111.2
Debt securities	3.2	4.9	26.6	80.6	0.9	116.2
Loans and advances to customers	12.4	19.9	5.0	164.2	1,203.1	1,404.6
Other assets	8.0	-	-	-	-	8.0
Total financial assets	**165.9**	**39.3**	**75.7**	**306.7**	**1,246.5**	**1,834.1**
Liabilities						
Deposit from banks	16.0	-	-	205.0	-	221.0
Deposit from customers	259.5	121.8	375.3	668.3	0.1	1,425.0
Derivative financial instruments	-	-	-	3.0	8.4	11.4
Other liabilities	13.9	-	-	-	-	13.9
Total financial liabilities	**289.4**	**121.8**	**375.3**	**876.3**	**8.5**	**1,671.3**
Loan commitments	**70.2**	**0.4**	**3.0**	**12.6**	**-**	**86.2**

• Financial instruments (continued)

e) Maturity profile of financial assets and liabilities (continued)

As at 30 September 2021	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Assets						
Cash and balances held at central banks	412.2	-	-	-	-	412.2
Loans and advances to credit institutions	45.9	-	-	-	-	45.9
Government bonds	-	-	-	-	29.8	29.8
Debt securities	6.1	0.5	-	34.7	1.0	42.3
Loans and advances to customers	89.2	30.8	44.0	229.6	667.9	1,061.5
Other assets	6.6	-	-	-	-	6.6
Total financial assets	**560.0**	**31.3**	**44.0**	**264.3**	**698.7**	**1,598.3**
Liabilities						
Deposit from banks	-	-	-	145.0	-	145.0
Deposit from customers	460.9	77.7	270.6	568.7	3.1	1,381.0
Derivative financial instruments	(0.1)	0.1	0.3	1.4	13.0	14.7
Other liabilities	9.9	-	-	-	-	9.9
Total financial liabilities	**470.7**	**77.8**	**270.9**	**715.1**	**16.1**	**1,550.6**

Loan commitments	**93.0**	**0.1**	**3.3**	**-**	**-**	**96.4**

f) Maturity profile of financial liabilities-contractual undiscounted cash flows

The table below analyses the Bank's non-derivative financial liabilities and net-settled derivative financial liabilities into relevant maturity groupings based on the period to maturity at the Balance Sheet. Derivative financial liabilities are included in the analysis if their contractual maturities are essential for an understanding of the timing of the cash flows. The amounts disclosed in the table are the contractual undiscounted cashflows.

As at 30 September 2022	Book value £m	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Financial liabilities							
Deposit from banks	221.0	16.0	-	-	218.3	-	234.3
Deposit from customers	1,425.0	259.6	122.3	379.7	686.9	0.1	1,448.6
Derivative financial instruments	11.4	-	-	-	2.5	10.9	13.4
Other liabilities	13.9	13.9	-	-	-	-	13.9
Total financial liabilities	**1,671.3**	**289.5**	**122.3**	**379.7**	**907.7**	**11.0**	**1,710.2**

As at 30 September 2021	Book value £m	Not more than three months £m	More than three months but not more than six months £m	More than six months but not more than one year £m	More than one year but not more than five years £m	More than five years £m	Total £m
Financial liabilities							
Deposit from banks	145.0	-	-	-	145.5	-	145.5
Deposit from customers	1,381.0	461.2	78.0	272.8	588.6	3.3	1,403.9
Derivative financial instruments	14.7	0.2	1.0	1.9	7.8	18.5	29.4
Other liabilities	9.9	9.9	-	-	-	-	9.9
Total financial liabilities	**1,550.6**	**471.3**	**79.0**	**274.7**	**741.9**	**21.8**	**1,588.7**

The above disclosures do not directly align to those presented for the Balance Sheet as they include interest relating to future periods. The contractual undiscounted cash flows related to derivative financial instruments used for risk management purposes are the net amounts for derivatives that are settled on a net basis.

g) Foreign currencies

The Bank holds no financial assets or liabilities denominated in foreign currencies.

27. Financial risk management objectives and policies

Risk management
The risk management approach encompasses the requirements for identifying, assessing, managing, monitoring and reporting on risk.

The evaluation of the various risks and the setting of policy is carried out through the Bank's Executive Risk Committee which reports to the Board Risk Committee, which ensures adherence to the Bank's Risk Management Policy and Framework.

Risk management objectives
Risk is inherent in all aspects of the Bank's business. The Risk Management Framework is in place to ensure that all material risks faced by the Bank have been identified and measured, and that appropriate controls are in place to ensure that each risk is mitigated to an acceptable degree.

In the normal course of its business, the Bank is exposed to credit risk, liquidity risk, house price risk, interest rate risk, conduct risk, operational risk and pension risk. These are discussed in more detail in sections a) to g) to follow.

(a) Credit risk

Credit risk is the risk that borrowers or a counterparty will be unable or unwilling to meet a commitment that they have entered into with the Bank.

The maximum credit risk as at 30 September is the carrying value recognised on the Balance Sheet as disclosed in the table in note 26(a), along with the loan commitments as disclosed in the table in note 26(e).

Credit risk within the Commercial lending portfolio is defined as a borrower's inability to repay or service their debt obligations. The primary drivers of credit risk in the Bank's case are property price risk and tenant risk.

The primary driver of credit risk within retirement mortgages and reversionary interests in property is a fall in house prices, which would cause credit losses should house prices fall sufficiently in real terms at the date of redemption.

The primary driver of credit risk within the treasury assets portfolio, which comprises deposits with other banks, government bonds and debt securities is counterparty default, meaning a counterparty can no longer repay its obligations. Only instruments issued by counterparties with a minimum rating of BBB- at the point of purchase are held.

The Bank intends to hold its treasury assets to maturity and is therefore not directly affected by market risk.

For both Commercial lending and Retail mortgages, the Bank takes security in the form of a legal charge over the property against which loans are advanced. The Bank's low risk approach to new business lending is reflected in the loan to value profile of the commercial property and retail property books.

The Bank manages its credit risk through its Retail Credit Committee, Commercial Credit Committee and Assets and Liabilities Committee. Regular credit exposure reports are produced which include information on credit and property underwriting, large exposures, asset concentration and levels of bad debt provisioning.

Credit risk in relation to loans and advances to customers, analysed between Retail lending credit risk, Commercial lending credit risk, Portfolio Buy-to-Let credit risk and credit risk in relation to treasury financial instruments is described in the relevant sections below.

Expected Credit Loss Provisioning
Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

- PD is the likelihood of a borrower defaulting on its financial obligation either in the next 12-months or over the remaining lifetime of the obligation.

The calculation of PD is specific to each portfolio as set out below:

Portfolio	Methodology for determining the PD
Retail mortgages	Calculated at an individual account level using the customer's credit score. The PD is derived from UK mortgage account performance data and overlaid with economic forecast assumptions to obtain a forward-looking PD.
Commercial and Portfolio Buy-to-Let	Calculated by making an assessment at an individual account level using a scorecard approach to determine the credit rating of the individual exposure which is linked to historical default rates of comparable entities. A credit cycle overlay model of a credit rating agency is used to calculate the forward-looking PD. The economic assumptions used within this model are obtained from multiple external sources.
Debt securities and government bonds	Calculated at an individual security level using the external credit agency's rating of the security which is linked to the historical default rates of comparable securities.

• Financial risk management objectives and policies (continued)

(a) Credit risk (continued)

Key Economic Scenario Assumptions

The key economic assumptions used to determine the forward-looking PD are as follows:

	Y1 %	Y2 %	Y3 %	Y4 %	Y5 %
UK GDP Growth					
Upside	(0.91)	1.31	2.00	1.96	1.85
Baseline	(1.41)	0.88	1.58	1.61	1.65
Downside	(1.74)	0.56	1.25	1.39	1.51
Scenario weighted forecasts	(1.45)	0.84	1.53	1.59	1.63
UK Unemployment Rate					
Upside	3.99	4.70	4.86	4.73	4.54
Baseline	4.54	5.50	5.65	5.52	5.31
Downside	5.05	6.12	6.36	6.31	6.19
Scenario weighted forecasts	4.63	5.59	5.78	5.68	5.51
% Change in S&P 500 Index[1]	(16.80)				
% Change in Energy Index	50.52	(12.40)	(11.92)	n/a	n/a
% Change in Non-Energy Index	19.2	(8.84)	(3.20)	n/a	n/a
% Change in Proportion of Downgrades[1]	(70.1)				

Note: 1. These are the historical annual changes and therefore these are only input for Y1 and then updated annually.

The PD models produce an estimate of the point-in-time PD reflecting the current and expected position in the current credit cycle.

The models are designed to produce ECL estimates under three distinct scenarios, reflecting expectations of general economic conditions.

The scenario weightings and the three distinct scenarios used to reflect the expectations of the wider economy that feed into the PD models for the year ended 30 September 2022 are:

Scenario	Scenario assumptions	Weighting
Upside	- Sanctions lift: An end to conflict in Ukraine and the lifting of curbs on Russian gas exports to Europe represents the most significant upside risk to the forecast. - Productivity: The Government's Capital Allowance Super Deduction could spur stronger growth in business investment over the next year than in the base case. - Fiscal Policy: The UK government is under pressure to increase support for household finances as the cost-of-living crisis worsens. This could see a less severe contraction in real personal disposable incomes and stronger outlook for consumer spending and GDP.	30.0%
Central	- No Covid-19 related restrictions are reimposed. - Continued conflict in Ukraine. Current sanctions remain. The global oil price peaks at $100 - $110 a barrel on a quarterly average basis. - 30% increase in the Ofgem energy price cap in January, and 15% in April. - The unemployment rate is expected to rise gradually to a peak of 5.7% in 2024. - CPI peaks at 14% in 2023Q1. Bank Rate rises to at least 3% in the spring. - In the long-term GDP is roughly 7% lower than in our pre-pandemic base case.	40.0%
Downside	- Russian oil and gas: At least a dozen European countries have been affected by cuts to gas supplies from Russia. Further cuts would send European wholesale prices higher. - Smaller labour force: Long-term sickness and retirement have reduced the size of the labour force relative to before the pandemic. If the fall in the participation rate persists, GDP growth could underperform the base case. - Domestic wage pressures: Persisting externally generated price inflation, specifically from rising global commodity prices could lead to domestically generated price and wage pressures becoming entrenched. - Covid-19 related restrictions elsewhere: The potential widening of lockdown restrictions in China is of particular concern.	30.0%

The scenario weightings and the three distinct scenarios used to reflect the expectations of the wider economy that feed into the PD models for the year ended 30 September 2021 are:

Scenario	Scenario assumptions	Weighting
Upside	- The key components of the Upside scenario are a quicker global recovery than expected and higher consumer confidence resulting in higher spending.	20.0%
Central	- The key components of the Central scenario are a continued recovery from the COVID-19 pandemic in the next 12 months with a modest growth in GDP thereafter of between 1% and 2%. - The unemployment rate is assumed to peak in Q4 of this year at 5.7% as a result of the removal of the furlough scheme with a gradual reduction in unemployment rates to around 4% in the third year of the forecast. - The anticipated rise in inflation to 4% in early 2022 to be temporary and will reduce as the supply side disruption dissipates.	40.0%
Downside	- The key component of the Downside scenario is the emergence of a new COVID-19 strain and the reintroduction of restrictive measures, prolonged high inflation and continued material and labour shortages.	40.0%

- EAD is based on the amounts the Bank expects to be owed at the time of default.

There are no significant judgements in determining the exposure at default.

- LGD represents the Bank's expectation of the extent of loss on defaulted exposures.

• Financial risk management objectives and policies (continued)

(a) Credit risk (continued)

The calculation of LGD is specific to each loan portfolio as set out below:

Portfolio	Methodology for determining the LGD
Retail mortgages	Calculated by using the Black Scholes model to reflect that the portfolio is secured against the underlying property as this will calculate the theoretical value of the total loss, should all policies default.
Commercial and Portfolio Buy-to-Let	Calculated by using an external credit rating agency's ECL model which provides an unbiased estimate of the LGD by blending different probabilities of the economic states occurring (positive, neutral and negative).
Debt securities and government bonds	Calculated on an individual security level using a credit rating agency's published average nominal recovery rate.

A sensitivity analysis has been performed to review the worst-case scenario and the impact on the LGD.

Credit risk: Retail exposures

The Bank's exposure to credit risk relating to loans and advances to retail customers can be broken down by security as follows:

	2022 £m	2022 %
Fully secured by a first charge on residential property	1,198.9	100.0
	1,198.9	**100.0**
Fair value adjustments	(0.3)	
	1,198.6	

	2021 £m	2021 %
Fully secured by a first charge on residential property	756.7	100.0
	756.7	**100.0**
Fair value adjustments	1.0	
	757.7	

The cumulative change in fair values due to credit risk amounts to losses of £0.1m (2021: £0.1m), and the change in the year is a gain of £nil (2021: gain of £2.1m).

Retail: risk concentrations

Loan to Value (LTV) is one of the main factors used to determine the credit quality of loans secured on residential property along with credit scores. All residential loans and receivables have an LTV of less than 75% when advanced.

The Bank provides loans secured on residential property across England, Northern Ireland, Scotland and Wales.

Retail: performance

The gross exposure on loans and advances to retail customers held at amortised cost and its exposure to credit risk in line with the internal modelling of the Bank for the period ending 30 September 2022 is disclosed below:

Stage	Description	Gross Loan Balance £m	ECL provision £m
Stage 1	Satisfactory	1,076.7	(0.1)
Stage 2	Watchlist	56.6	(0.1)
Stage 3	Default	2.2	(0.1)
Post Model Adjustment			(0.2)
		1,135.5	**(0.5)**
Plus: Loan fee deferral		5.0	
Provisions for impairment		(0.5)	
Total		**1,140.0**	

A deterioration in a customer's credit score since inception of greater than or equal to 160 points results in a loan being moved to Stage 2. Any loan that is 90-days past due is classified as being in default and therefore is allocated to Stage 3.

The gross exposure on loans and advances to retail customers held at amortised cost and its exposure to credit risk in line with the internal modelling of the Bank for the period ending 30 September 2021 is disclosed below:

Stage	Description	Gross Loan Balance £m	ECL provision £m
Stage 1	Satisfactory	654.3	(0.1)
Stage 2	Watchlist	21.4	(0.0)
Stage 3	Default	0.8	(0.0)
		676.5	**(0.1)**
Plus: Loan fee deferral		2.6	
Provisions for impairment		(0.1)	
Total		**679.0**	

• Financial risk management objectives and policies (continued)

(a) Credit risk (continued)

The movement between stages based on the gross exposure on loans is disclosed below:

Stage	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 4 £m
At 30 September 2021	654.3	21.4	0.8	676.5
Advances	512.4	-	-	512.4
Stage transfers	(40.2)	38.8	1.4	-
Repayment and settlement	(49.8)	(3.6)	-	(53.4)
At 30 September 2022	**1,076.7**	**56.6**	**2.2**	**1,135.5**

Arrears

Performance risk is measured by those accounts in arrears. The total balances in arrears at 30 September 2022 amounted to £5.5m (2021: £1.5m).

Past due but not impaired

As at 30 September 2022 there were no retail exposures that were past due but not impaired (2021: £nil).

Forbearance

There have been no instances of forbearance arising during the year.

Sensitivity

A 100% weighting for a negative scenario produces an additional ECL provision for Stage 1, 2 and 3 of £nil (2021: £0.1m).

Credit risk: Commercial lending

Commercial: analysis of risk concentration

Loans secured on commercial property are as follows:

	2022		2021	
	Loan Balance £m	Collateral Held £m	Loan Balance £m	Collateral Held £m
Commercial mortgage	29.9	46.5	30.2	46.9
Development finance	12.9	14.7	19.1	26.4
Investment loans	135.8	245.6	176.7	292.6
Renewable energy	11.7	-	16.3	-
	190.3	**306.8**	**242.3**	**365.9**
Less: Loan fee deferral	(1.0)	-	(1.1)	-
Provisions for impairment	(7.1)	-	(7.3)	-
	182.2	**306.8**	**233.9**	**365.9**

At inception, commercial property loans are fully secured against the value of the related properties.

The Bank provides loans secured on property across England, Scotland and Wales. An analysis of commercial property and renewable energy sector loans by geographical location of the underlying asset is provided below:

	2022		2021	
	£m	%	£m	%
Wales	35.6	18.7	44.0	18.2
London – England	88.4	46.4	99.5	41.1
South East & East of England	7.4	3.9	9.7	4.0
Midlands – England	20.9	11.0	26.4	10.9
South West of England	33.7	17.7	47.1	19.4
North West & North East of England	1.7	0.9	7.5	3.1
Scotland	2.6	1.4	8.1	3.3
	190.3	**100.0**	**242.3**	**100.0**

The average LTV in respect of Commercial loans is estimated to be 63.3% (2021: 63.7%). LTV analysis has been undertaken by using a combination of external valuations and internal and external desktop reviews which consider the type and quality of security, lease term/tenant as well as geographical location.

£5.5m (2021: £10.6m) of exposures have an LTV of greater than 100%. Of these, £5.5m (2021: £7.3m) are already classified as in default.

The largest exposure to one counterparty is £15.2m (2021: £15.2m) or 8% (2021: 6.3%) of gross balances.

• Financial risk management objectives and policies (continued)

(a) Credit risk (continued)

Commercial: lending performance

Procedures are in place which grade borrowers in line with the perceived severity of the risk and are designed to identify cases of potential cause for concern to facilitate early risk mitigation or forbearance activity where appropriate. Using this risk grading system, the gross balance of the commercial loan portfolio is classified as follows:

	2022		2021	
	£m	%	£m	%
Stage 1	142.7	75.0	159.0	65.6
Stage 2 – significant increase in credit risk	31.8	16.7	66.3	27.4
Stage 3 – default	15.8	8.3	17.0	7.0
	190.3	**100.0**	**242.3**	**100.0**

The movement between stages based on the gross exposure on loans is disclosed below:

Stage	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 4 £m
At 30 September 2021	159.0	66.3	17.0	242.3
Advances and interest	20.4	-	0.3	20.7
Stage transfers	3.6	(3.6)	-	-
Repayment and settlement	(40.3)	(30.9)	(1.5)	(72.7)
At 30 September 2022	**142.7**	**31.8**	**15.8**	**190.3**

Exposure by credit rating

The gross exposure on Commercial loans and their exposure to credit risk in line with internal risk grades and the corresponding external credit rating agency's credit risk rating at 30 September 2022 is disclosed below:

Risk grade	Description	Stage	S&P Rating	Gross Loan Balance £m	ECL Provision £m
1	Negligible risk	Stage 1	AAA to A-	0.1	-
2.2	Low risk	Stage 1 or 2	BB+ to BB	17.8	-
3.1	Fair risk	Stage 1 or 2	BB to BB-	63.7	(0.7)
3.2	Moderate risk	Stage 1 or 2	B+ to B-	54.1	(0.3)
4.1	Watch	Stage 1 or 2	B- to CCC	32.0	(0.5)
4.2	Enhanced watch	Stage 1 or 2	CCC	3.8	(0.2)
5	Substandard	Stage 2	CCC to CCC-	3.0	(0.1)
6	Default	Stage 3	CCC-	9.8	-
7	Loss	Stage 3	CCC-	6.0	(4.9)
	Post Model Adjustment			-	(0.4)
Total				**190.3**	**(7.1)**

The gross exposure on Commercial loans and their exposure to credit risk in line with internal risk grades and the corresponding external credit rating agencies credit risk rating at 30 September 2021 is disclosed below:

Risk grade	Description	Stage	S&P Rating	Gross Loan Balance £m	ECL Provision £m
2.2	Low risk	Stage 1 or 2	BB+ to BB	25.4	-
3.1	Fair risk	Stage 1 or 2	BB to BB-	44.8	(0.6)
3.2	Moderate risk	Stage 1 or 2	B+ to B-	71.2	(0.4)
4.1	Watch	Stage 1 or 2	B- to CCC	54.4	(0.6)
4.2	Enhanced watch	Stage 1 or 2	CCC	21.6	(0.7)
5	Substandard	Stage 2	CCC to CCC-	7.9	-
6	Default	Stage 3	CCC-	9.7	-
7	Loss	Stage 3	CCC-	7.3	(5.0)
Total				**242.3**	**(7.3)**

• Financial risk management objectives and policies (continued)

(a) Credit risk (continued)

Arrears

As at 30 September 2022 there were £17.2m of commercial loans in arrears (2021: £3.0m).

Past due but not impaired

As at 30 September 2022 there was £nil (2021: £nil) commercial loan balances that were past due but not impaired.

Forbearance

There has been one instance of forbearance arising during the year £9.9m (2021: £6.6m).

Sensitivity

A 100% weighting for a Negative scenario produces an additional ECL provision for Stage 1 and Stage 2 of £1.1m (2021:£0.9m).

The maximum post model adjustment for the lag in the current economic climate filtering through to lower credit ratings for commercial customers that are deemed to be the highest risk of default in the next 12 months from the impact of high inflation and higher interest rates amounts to £1.4m.

Credit risk: Portfolio Buy-to-Let (PBTL)

PBTL: analysis of risk concentration

Loans secured on PBTL property are as follows:

	2022		2021	
	Loan Balance £m	Collateral Held £m	Loan Balance £m	Collateral Held £m
PBTL lending	77.8	115.7	71.5	106.9
	77.8	**115.7**	**71.5**	**106.9**

On inception, PBTL property loans are fully secured against the value of the related properties.

The Bank's PBTL loan portfolio comprises the following:

	2022		2021	
	£m	%	£m	%
Loans secured on PBTL property	77.8	100.0	71.5	100.0
	77.8	**100.0**	**71.5**	**100.0**
Less: Loan fee deferral	(0.1)		(0.1)	
Provisions for impairment	(1.2)		(0.9)	
	76.5		**70.5**	

The Bank provides loans secured on property across England, Scotland and Wales. An analysis of PBTL property loans by geographical location is provided below:

	2022		2021	
	£m	%	£m	%
Wales	3.8	4.9	3.0	4.2
London – England	47.5	61.0	56.4	78.8
South East & East of England	13.5	17.4	2.2	3.1
Midlands – England	7.5	9.6	3.8	5.3
North West - England	1.3	1.7	1.3	2.0
South West of England	4.2	5.4	4.8	6.6
	77.8	**100.0**	**71.5**	**100.0**

The average LTV in respect of PBTL loans is 65.8% (2021:64.2%). LTV analysis has been undertaken by using a combination of external valuations and internal and external desktop reviews which consider the type and quality of security, lease term/tenant as well as geographical location. No exposures have an LTV of greater than 100%.

The largest exposure to one counterparty is £11.0m (2021:£11.4m) or 14.1% (2021:16%) of gross balances.

• Financial risk management objectives and policies (continued)

(a) Credit risk (continued)

PBTL: lending performance

Procedures are in place which grade borrowers in line with the perceived severity of the risk and are designed to identify cases of potential cause for concern to facilitate early risk mitigation or forbearance activity where appropriate. Using this risk grading system, the gross value of the PBTL portfolio is classified as follows:

	2022		2021	
	£m	%	£m	%
Stage 1	71.3	91.6	55.9	78.2
Stage 2 – significant increase in credit risk	6.5	8.4	13.4	18.7
Stage 3 – default	-	-	2.2	3.1
	77.8	**100.0**	**71.5**	**100.0**

The movement between stages based on the gross exposure on loans is disclosed below:

Stage	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 4 £m
At 30 September 2021	55.9	13.4	2.2	71.5
Stage transfers	8.6	(6.4)	(2.2)	-
Advances	6.7	-	-	6.7
Repayment and settlement	-	(0.4)	-	(0.4)
At 30 September 2022	**71.2**	**6.6**	**-**	**77.8**

PBTL: lending provisions

Exposure by credit rating

The gross exposure on PBTL financial assets and its exposure to credit risk in line with an external credit rating agency's credit risk rating is disclosed below:

30 September 2022

Risk grade	Description	Stage	Credit Rating	Gross Loan Balance £m	ECL Provision £m
2.2	Low risk	Stage 1	BB+ to BB	9.9	-
3.1	Fair risk	Stage 1 or 2	BB to BB-	13.2	-
3.2	Moderate risk	Stage 1 or 2	B+ to B-	37.2	(0.3)
4.1	Watch	Stage 1 or 2	B- to CCC	11.0	(0.3)
4.2	Enhanced watch	Stage 1 or 2	CCC	4.3	(0.2)
5	Substandard	Stage 2	CCC to CCC-	2.2	(0.2)
	Post Model Adjustment				(0.2)
Total				**77.8**	**(1.2)**

30 September 2021

Risk grade	Description	Stage	Credit Rating	Gross Loan Balance £m	ECL Provision £m
2.2	Low risk	Stage 1	BB+ to BB	7.2	-
3.1	Fair risk	Stage 1 or 2	BB to BB-	10.5	-
3.2	Moderate risk	Stage 1 or 2	B+ to B-	35.9	(0.5)
4.1	Watch	Stage 1 or 2	B- to CCC	15.7	(0.4)
6	Default	Stage 3	CCC-	2.2	-
Total				**71.5**	**(0.9)**

Arrears

As at 30 September 2022 there were £2.2m of PBTL loans in arrears (2021: £2.2m).

Past due but not impaired

As at 30 September 2022 there were no PBTL loans that were past due but not impaired (2021: £nil).

Forbearance

There have been no instances of forbearance arising during the year.

Sensitivity

A 100% weighting for a Negative scenario produces an additional ECL provision for Stage 1 and 2 of £0.1m (2021:£0.4m).

The maximum post model adjustment for the lag in the current economic climate filtering through to lower credit ratings for Portfolio Buy-to-Let customers that are deemed to be the highest risk of default in the next 12 months from the impact of high inflation and higher interest rates amounts to £2.5m.

• Financial risk management objectives and policies (continued)

(a) Credit risk (continued)

Credit risk: Treasury assets

Treasury risk comprises exposure to central banks, government bonds, debt securities, credit institutions and financial derivatives. The following table shows the maximum exposure to credit risk excluding collateral:

	2022 £m	2021 £m
Cash and balances held at central banks	118.1	412.2
Loans and advances to credit institutions	0.2	45.9
Government bonds	111.2	29.8
Debt securities	116.2	42.3
	345.7	**530.2**
Provision for impairment	-	-
	345.7	**530.2**

None of these exposures are past due or impaired.

Credit quality of financial assets that are neither past due nor impaired

The following shows the exposures broken down by credit rating:

	2022 £m	2021 £m
AAA to AA-	345.5	530.2
A+ to A-	0.2	-
	345.7	**530.2**

Concentration of credit risk

The geographical exposure is as follows:

	2022 £m	2021 £m
UK	254.6	517.1
Other	91.1	13.1
	345.7	**530.2**

The Treasury function monitors exposure concentrations against a variety of criteria including counterparty limits.

• Financial risk management objectives and policies (continued)

b) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in realising assets or otherwise raising funds to meet commitments as they fall due. The Bank manages its liquidity risk through its Assets and Liabilities Committee and monitors its liquidity position on a daily basis and has adopted a policy to ensure that it has adequate resources to enable it to conduct its normal business activities without interruption. The maturity analysis of assets and liabilities is disclosed in note 26 (e) & (f) to the financial statements of the Bank.

The customer deposit base represents a stable source of funding due to the number and range of depositors. Liquidity is further managed through dealings in the money markets.

The Board has approved a Liquidity Risk Management policy that sets out the liquidity requirements with which the Bank must comply. The principal liquidity risk mitigants used by management are:

- A buffer of highly liquid assets (comprising high quality government, covered bonds and supranational bank securities) which can meet cash requirements;
- Cash reserves with the Bank of England;
- Cash resources held at other financial institutions.

c) Interest rate risk

Interest rate risk is the risk that arises when there is an imbalance between the maturity dates of rate-sensitive assets, liabilities and commitments. The Bank manages its interest rate risk through its Assets and Liabilities Committee. The Bank's policy is to maintain interest rate risk at a controlled level within limits set by the Board.

The table in note 26 (d) shows an estimate of the interest rate sensitivity gap as at 30 September 2022. The principal risk management tool to mitigate interest rate risk is the use of derivatives to align the interest rate re-pricing profile of assets and liabilities. All of the derivatives used by the Bank are interest rate swap contracts of varying maturities and start dates.

The Bank's Interest Rate Risk Management policy defines the type of derivative transactions that can be undertaken, which are all actioned by the Bank's Treasury function, and are subject to review and approval at the dealing stage. The Treasurer, who is responsible for treasury matters on a day to day basis, prepares a treasury report for the Board, which includes analysis of interest rate risk exposures.

d) Operational risk

Operational risk is the risk of economic loss from systemic failure, human error and fraud (control failures) or external events, which result in unexpected or indirect loss to the Bank. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications or can lead to financial loss. The Bank cannot expect to eliminate all operational risks but by initiating a rigorous control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access controls, authorisation and reconciliation procedures, staff education and assessment processes, including the use of internal audit.

e) House price risk

House price risk is the risk that arises when there is an adverse mismatch between actual house prices and those implicit in the costing of the Bank's retirement mortgages and reversionary interests held at FVTPL such that the ultimate realisation of the property would not yield the expected return to the Bank and could, in certain circumstances, result in a capital loss. The Bank mitigates house price risk by monitoring maximum loan to value at inception of the loan and reversionary interests.

Geographical analysis of retirement mortgages

The Bank provides loans secured on property across England, Scotland and Wales. An analysis of retail property by geographical location is provided below.

	2022		2021	
	£m	%	£m	%
Wales	3.0	5.1	3.3	4.4
East Anglia	2.3	3.9	2.9	3.8
East Midlands	2.5	4.3	3.5	4.7
Greater London	3.4	5.8	5.0	6.6
Yorkshire & Humberside	4.4	7.5	5.5	7.3
North West	6.0	10.2	7.2	9.5
Scotland	11.0	18.8	14.4	19.0
Outer Metropolitan	3.5	6.0	5.2	6.9
Outer South East	8.5	14.5	10.6	14.0
South West	6.5	11.1	9.0	11.9
West Midlands	4.7	8.0	5.4	7.1
North	2.8	4.8	3.7	4.8
	58.6	**100.0**	**75.7**	**100.0**

f) Conduct risk

Conduct risk is the risk that the Bank's behaviour results in poor outcomes for customers. The Bank is exposed to this risk by virtue of the markets in which it chooses to operate. The Executive Risk Committee has overall responsibility for implementing and monitoring principles, frameworks, policies and limits. The Committee is responsible for managing risk decisions and monitoring risk levels which it reports to the Risk and Conduct Committee.

The Bank holds a provision of £nil as at 30 September 2022 (2021: £nil).

g) Pension risk

The Bank is exposed to pension risk through its defined benefit scheme. Further information is provided in note 24.

h) Pandemic risk

Pandemic risk is the risk of economic loss from a result of a pandemic. The Executive Risk Committee has overall responsibility for implementing and monitoring risks that a pandemic could cause. The Committee is responsible for managing risk decisions and monitoring risk levels which it reports to the Board Risk Committee.

28. Capital risk management (unaudited)

The Bank conducts an Internal Capital Adequacy Assessment Process (ICAAP), at least annually, which is approved by the Board. This is used to assess the Bank's capital adequacy and to determine the level of capital required to support the future development of the business as set out in the strategic plan.

The ICAAP considers all of the Bank's material risks and includes board-approved stress scenarios which are intended, as a minimum, to meet regulatory requirements. The ICAAP is used by the PRA to set the Bank's Total Capital Requirements (TCR).

The Bank's capital resources requirements are calculated based on the CRD IV CRR regulatory framework as implemented by the PRA, namely:

- Pillar 1-based on a Standardised Approach for credit risk, operational risk and market risk;
- Pillar 2-set by the PRA via the TCR to address those risks not covered under Pillar 1.

The Board is ultimately responsible for capital management and monitors the capital position of the Bank at each board meeting through the receipt of management information which sets out the Bank's current and forecast capital position, based on the methodology adopted within its ICAAP. This means that the Bank will:

i) Maintain a level of capital at least equal to the minimum amount set by the PRA in the TCR, and;

ii) Hold all its capital in the form of Common Equity Tier 1 and Tier 2 capital.

	2022 Unaudited	2021 Unaudited
Common Equity Tier 1 capital	177.4	143.8
Total risk weighted assets	705.0	771.0
Common Equity Tier 1 capital ratio	25.2%	20.2%
Total own funds	177.4	143.8
Total risk weighted assets	705.0	711.0
Total capital ratio	25.2%	20.2%

Capital Requirements Directive

Article 89 of the Capital Requirements Directive IV (CRD IV) requires credit institutions and investment firms in the EU to disclose annually, specifying, by Member State and by third country in which it has an establishment, the following information:

- Name, nature of activities and geographical location: The principal activities of the Bank are noted in the Strategic Report.
- Average number of employees: as disclosed in note 6 to the accounts.
- Annual turnover (Net Interest Income) and profit before tax: as disclosed in the Income Statement.
- Corporation Tax paid: 2022: £nil (2021: £nil).

All minimum regulatory requirements were met during the year and the prior year.

The Bank's objectives when managing capital are:

- To have sufficient capital to safeguard the Bank's ability to continue as a going concern so that it can continue to provide returns for the Shareholder and benefits for other stakeholders;
- To comply with the Bank's capital requirements set out by the PRA in the UK;

The Bank's capital comprises all components of equity, movements of which are set out in the Statement of Changes in Equity.

29. Financial commitments

	2022 £m	2021 £m
Loan Commitments		
Expiring in less than one year	73.6	96.4
Expiring in more than one year	12.6	-
	86.2	**96.4**

Capital commitments

The Bank had contracted capital commitments amounting to £nil at 30 September 2022 (2021: £nil).

30. Related parties

The Bank has applied the exemptions available under FRS 101 in respect of transactions with members of The Carlyle Trust Limited group.

The following balances were owed to or from related parties at 30 September 2022 and 30 September 2021:

	2022 £m	2021 £m
Amounts due/(owed) from parent and fellow subsidiaries		
The Carlyle Trust Limited – parent	-	0.3
Reimbursement liability due to The Carlyle Trust Limited	(0.2)	-
SWAP collateral liability due to Hodge Reversions Limited	(3.4)	-
Group relief debtor	1.0	0.1
Total	**(2.6)**	**0.4**
Jane Hodge Foundation – shareholder of The Carlyle Trust Limited	(2.0)	(5.3)
Deposits owed to parent and fellow subsidiaries		
Hodge Developments (Beaufort Park) Limited	-	(0.1)
Sterling House Limited	(0.1)	(0.2)
Wingwest (Fountain Lane) Limited	(0.1)	(0.2)
The Carlyle Trust Limited – parent	(10.0)	(128.6)
Carlyle Property Development Limited	(0.3)	(0.7)
Hodge Limited	(0.3)	(2.9)
Hodge Reversions Limited	(0.5)	-
Total	**(11.3)**	**(132.7)**

31 . Maturity analysis of assets and liabilities

The table below provides an analysis of assets

At 30 September 2022	Due within 12 months £m	Due after 12 months £m	Total £m
Assets			
Cash and balances held at central banks	118.1	-	118.1
Loans and advances to credit institutions	0.2	-	0.2
Derivative financial instruments	(0.2)	76.0	75.8
Government bonds	82.8	28.4	111.2
Debt securities	34.7	81.5	116.2
Loans and advances to customers	37.3	1,367.3	1,404.6
Intangible assets	2.0	7.7	9.7
Property, plant & equipment	0.5	1.0	1.5
Investment properties	9.2	-	9.2
Deferred tax assets	1.7	4.6	6.3
Other assets	8.0	-	8.0
Total assets	**294.3**	**1,566.5**	**1,860.8**
Liabilities			
Deposits from banks	16.0	205.0	221.0
Deposits from customers	756.6	668.4	1,425.0
Derivative financial instruments	-	11.4	11.4
Other liabilities	13.9	-	13.9
Pension liabilities	1.6	2.9	4.5
Total liabilities	**788.1**	**887.7**	**1,675.8**

At 30 September 2021	Due within 12 months £m	Due after 12 months £m	Total £m
Assets			
Cash and balances held at central banks	412.2	-	412.2
Loans and advances to credit institutions	45.9	-	45.9
Government bonds	-	29.8	29.8
Debt securities	6.6	35.7	42.3
Loans and advances to customers	164.0	897.5	1,061.5
Intangible assets	1.8	5.6	7.4
Property, plant & equipment	0.5	1.1	1.6
Investment properties	76.7	17.9	94.6
Deferred tax assets	5.2	6.3	11.5
Other assets	6.6	-	6.6
Total assets	**719.5**	**993.9**	**1,713.4**
Liabilities			
Deposits from banks	-	145.0	145.0
Deposits from customers	809.2	571.8	1,381.0
Derivative financial instruments	0.3	14.4	14.7
Other liabilities	9.9	-	9.9
Pension liabilities	1.2	13.0	14.2
Total liabilities	**820.6**	**744.2**	**1,564.8**

32. Post balance sheet events

There have been no post balance sheet events.

33. Contingent assets and liabilities

There are no contingent assets or liabilities at 30 September 2022 (2021: nil).

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