Charter Court Financial Services Limited

Annual Report and Financial Statements

For the Year Ended 31 December 2022

Registered Number: 06749498

Charter Court Financial Services Limited
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Charter Court Financial Services Limited
Company Information

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COMPANY SECRETARY	David Morgan
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REGISTERED NUMBER	06749498 (England and Wales)
AUDITOR	Deloitte LLP Statutory Auditor London United Kingdom

Charter Court Financial Services Limited
Strategic Report

For the Year Ended 31 December 2022

The Directors present their Annual Report, including the Strategic Report, Directors' Report and Statement of Directors' Responsibilities, together with the audited financial statements and Auditor's Report for the year ended 31 December 2022.

Charter Court Financial Services Limited's (the Company or CCFSL) parent company is Charter Court Financial Services Group Plc (CCFSG). The Company's ultimate parent is OSB GROUP PLC (OSBG), the Group comprises OSBG and its subsidiaries.

Principal activities

The principal activities of the Company comprise the provision of Buy-to-Let (BTL) and residential mortgage loans, secured short-term lending (bridging), second charge loans, savings products, mortgage administration services and a range of analytical services within the UK residential mortgage sector.

The Company operates under three brands: Charter Savings Bank, Precise Mortgages and Exact Mortgage Experts.

Business model

Our purpose is to help our customers, colleagues and communities prosper.

We provide specialist mortgage lending with strong levels of mortgage originations, extensive underwriting expertise, award winning product propositions and strong relationships with intermediaries. Our strategic priorities are to be the leading specialist lender in our chosen market sub-segments, retain focus on our automated risk assessment platforms and further deepen relationships and distribution with intermediaries.

We have a sophisticated funding platform with reliable savings funding through the Charter Savings Bank brand and operate within the wider Group utilising capital market expertise with securitisation platforms allowing for programmatic issuance of high quality residential mortgage-backed securities (RMBS). The Company intends to maintain a diversified approach, through pooled funding platforms, to funding mortgage lending whilst remaining predominantly retail funded. Our strategic priorities are to provide cost-efficient funding through a resilient and diversified funding platform to support our future growth and deliver consistently good value savings products to our customers.

Our operating model has access to deep credit experience and analytics, a continued focus on disciplined cost management and access to the Group's customer servicing centre in India. Our strategic priorities are to leverage the Group's unique and cost effective operating model, continue to leverage deep credit expertise and data analytics and to maintain an efficient, scalable and resilient infrastructure.

Business review

Profit after taxation for the year totalled £194.2m (2021: £137.9m).

Net interest income (NII) for the year increased by 32% to £303.5m (2021: £230.0m) reflecting strong growth in the loans book that increased to £10.3bn as at 31 December 2022 (31 December 2021: £8.8bn) and an improved net interest margin (NIM) due to base rate rises during the year. There were delays, especially in the first half of the year, in the market passing base rate rises onto savers in full. In addition, as rates rose, mortgage interest income benefitted from higher expected reversionary income following the end of the fixed product term. This benefit was partially offset by an expectation that customers would spend less time on the higher reversionary rate before refinancing.

Fair value gains on financial instruments of £42.2m (2021: £11.9m gain) was mainly due to unmatched swaps. The net gain on unmatched swaps related primarily to fair value movements on mortgage pipeline swaps prior to them being matched against completed mortgages. This benefitted from a step up in interest rate outlook on the SONIA yield curve largely in response to the actions announced in the September mini budget. The Company economically hedges its committed pipeline of mortgages and this unrealised gain unwinds over the life of the swaps through hedge accounting inception adjustments.

Business review (continued)

Administrative expenses increased by 14% to £75.2m (2021: £65.7m) reflecting the anticipated return to a more normalised level post pandemic expenditure, inflationary headwinds and investment to support the ongoing growth in the business.

The Company recorded an impairment charge of £8.6m in 2022 (2021: £8.1m credit), with the provision charge primarily driven by more severe macroeconomic scenarios and post-model adjustments to account for the rising cost of living and borrowing as well as the strong growth in loan book in the year. Further detail is provided in the Principal risks and uncertainties section.

Integration costs, the post-acquisition costs incurred in integrating the operations of OneSavings Bank plc (OSB) and CCFSG, incurred during 2022 were £0.8m (2021: £1.0m). The three year integration programme has now completed during 2022.

The Company generated £3.0bn in new mortgage originations (2021: £2.2bn), up 36% on the previous year (2021: up 16%), due to strong demand in our core sub-segments reflecting the market demand for housing and increases in house prices.

The Company's BTL originations were up 35% on the previous year at £2.0bn (2021: £1.5bn). The BTL loan book increased to £7.5bn (2021: £6.3bn). Demand was again particularly strong from those borrowing via a limited company structure, which represented 65% of BTL completions in 2022 (2021: 69%).

At the year end the residential loan book was £2.5bn, an increase of 9% from £2.3bn at 31 December 2021. The Company's specialist residential lending originations were £749.0m (2021: £558.0m) driven by the Company's expertise, with a strong focus on first time buyers, including those purchasing through the Help to Buy scheme, self-employed individuals and those with minor adverse records. The Help to Buy scheme closed to new applications in October 2022, with completions for new purchases required by 31 March 2023 and represented 19% of completions in this sub-segment in the year (2021: 86%).

The Company continued to focus on its bridging offering. Short-term bridging originations nearly doubled in the year to £217.5m (2021: £109.1m) and as a result the gross loan book in this sub-segment increased to £149.7m as at 31 December 2022 (2021: £56.3m).

The second charge gross loan book reduced to £111.9m compared with £153.7m as at 31 December 2021. The second charge products under the Precise Mortgages brand were withdrawn in August 2022. The Company also manages a small number of portfolios of third party client assets along with Precise Mortgages' originations, covering both securitised and non-securitised loan portfolios.

At the end of 2022, the Company had 156,095 savings customers (2021: 145,361), operating 209,465 savings accounts (2021: 193,354), with an average balance per account of £34,000 (2021: £34,900). Retail savings products provide a relatively stable source of funds for the Company. There was a small increase in the percentage of savings deposited in fixed term and notice-based products at the year end to 79.7% (31 December 2021: 78.2%).

The Company has a wide range of savings products, including easy access, fixed term bonds, cash ISAs and business savings accounts. In line with its dynamic funding strategy, the Company continues to diversify its retail funding sources through pooled funding platforms. The range of products sourced via these platforms includes easy access and non-retail deposits.

In 2022, the Company continued to be rewarded by the industry, winning 10 awards, including Best Overall Savings Provider from Personal Finance Awards, Award for Customer Service from Savings Champion Awards, and Best Internet Account Provider and Best Bank Savings Provider, both from Moneyfacts Awards.

Business review (continued)

The Company has built attractive diversification opportunities to supplement its retail funding. The Company uses its securitisation platform as a means of providing low-cost, term duration funding. Wholesale funding has enabled the business to rebalance the weighted average life of liabilities away from shorter duration retail funding and thereby optimise the funding mix.

The Company recognises the cyclical nature of capital markets funding and therefore utilises it opportunistically, taking advantage of favourable market conditions. The Company has been a programmatic issuer of high-quality RMBS through the Precise Mortgage Funding and Charter Mortgage Funding franchises and although no securitisations were completed in 2022, the Company has completed 14 securitisations worth more than £4.5bn to 31 December 2022.

The Term Funding Scheme (TFS) with additional incentives for SMEs (TFSME) drawings remained unchanged from 2021 at £1.8bn. These borrowings provide four-year funding at a cost of Bank Base Rate.

The net assets of the Company increased from £780.6m to £894.1m in 2022. Dividends of £75.2m were paid during the year (2021: nil). The Directors propose a final dividend of £44.9m for the year ended 31 December 2022.

The Company's capital resources and requirements are determined on the basis of the Capital Requirements Directive IV regulatory framework, as implemented by the Prudential Regulation Authority (PRA) in the United Kingdom. Regulatory capital is reviewed on a regular basis by the Board and the Group Assets and Liabilities Committee (ALCO) on both a current and forward-looking basis. The Company's Internal Capital Adequacy Assessment Process (ICAAP) is used to assess the Company's capital adequacy and determine the levels of capital required to support the current and future risks in the business derived from its five year corporate plan. It is subjected to a supervisory review and evaluation process (CSREP) by the PRA.

At 31 December 2022 the Company's Common Equity Tier 1 (CET1) ratio was 18.8% (31 December 2021: 20.0%). The CET1 ratio reduced but remains strong and meets all regulatory requirements.

The Company holds liquid assets above its regulatory minimum requirement to ensure obligations can be met as they fall due on a business as usual and stressed basis. The appropriateness of the Company's liquidity risk appetite and risk management framework and controls is subject to at least an annual review through the Internal Liquidity Adequacy Assessment Process (ILAAP). As at 31 December 2022 the Company held £1,478.3m (2021: £1,182.9m) of liquid assets, consisting of Bank of England (BoE) Reserve Account balances. The Company's main source of funding is retail deposits. The Company also has access to facilities provided by the BoE including pre-positioning collateral with the BoE, enabling access to further funding and liquidity facilities at short notice.

Future developments

Charter Savings Bank and Funding

The Company continues to explore opportunities to further diversify its retail funding base, which is administered by a third party, seeking out new products, markets and channels to enhance its range and reduce cost of funds whilst continuing to meet consumer needs.

The Company will continue to look at other funding options to supplement the retail savings. Previously mortgage assets were sold to a sister company to set up securitisation structures, going forwards the intention is to securitise assets direct from the Company's balance sheet.

Precise lending book

The Company will continue to provide specialist mortgages. Our strategic priorities are to be the leading specialist lender in our chosen markets, retaining focus on our automated risk assessment platforms and further deepen relationships and distribution with intermediaries.

Risk review

Management of climate change risk

Climate change risk is managed on behalf of the Company by the Group. There was further embedding of the Group's approach to climate risk during 2022, with the Climate Risk Management Framework and Environmental, Social and Governance (ESG) governance structures now established.

The Company is exposed to the following climate related risks:

- Physical risk – relates to climate or weather-related events such as heatwaves, droughts, floods, storms, rising sea levels, coastal erosion and subsidence. These risks could result in financial losses with respect to the Company's own real estate and customer loan portfolios.
- Transition risk – arising from the effect of adjusting to a low-carbon economy and changes to appetite, strategy, policy or technology. These changes could result in a reassessment of asset values and increased credit exposures for banks and other lenders as the costs and opportunities arising from climate change become apparent. Reputational risk arises from a failure to meet changing and more demanding societal, investor and regulatory expectations.

Approach to analysing climate risk

As part of the ICAAP, the Risk function engaged with a third party to provide detailed climate change assessments at a collateral level for the Company's loan portfolios. The data was in turn utilised to conduct profiling and financial risk assessments.

a) Climate scenarios considered

The standard metric for assessing climate change risk is the global greenhouse gas concentration as measured by Representative Concentration Pathway (RCP) levels. The four levels adopted by the Intergovernmental Panel for Climate Change for its fifth assessment report (AR5) in 2014 are:

Emissions scenario

Scenario	Change in temperature (°C) by 2100
RCP 2.6	1.6 (0.9 – 2.3)
RCP 4.5	2.4 (1.7 – 3.2)
RCP 6.0	2.8 (2.0 – 3.7)
RCP 8.5	4.3 (3.2 – 5.4)

Note: figures within the brackets above detail the range in temperatures. Single figures outside the brackets indicate the averages.

b) Climate risk perils considered

The following three physical perils of climate change were assessed:

- Flood - wetter winters and more concentrated rainfall events will increase flooding.
- Subsidence - drier summers will increase subsidence via the shrink or swell of clay.
- Coastal erosion - increased storm surge and rising sea levels will increase the rate of erosion.

For each of the physical perils and climate scenarios detailed above, a decade by decade prediction, from the current year to 2100 on the likelihood of each was provided.

Risk review (continued)

Management of climate change risk (continued)

For flood and subsidence, the likelihood took the form of a probability that a flood or subsidence event would occur over the next ten years. For coastal erosion the distance of the property to the coast line is provided by scenario and decade.

All peril impacts are calculated at the property level to a one metre accuracy. This resolution is essential because flood and subsidence risk factors can vary considerably between neighbouring properties.

In addition to the physical perils, the current Energy Performance Certificate (EPC) of each property was considered to allow for an assessment of transitional risk due to policy change. EPC ratings are based on a Standard Energy Procedure (SAP) calculation which uses a methodology to determine the energy performance of properties by considering factors such as construction materials, heating systems, insulation and air leakage.

The Company's loan portfolio was profiled against each of the perils detailed under the best (RCP 2.6) and worst (RCP 8.5) climate scenarios.

- Flood risk

By the 2030's, at the Company level, the percentage of properties predicted to experience a flood is expected to increase from 0.46% (2021: 0.46%) in the least severe scenario to 0.49% (2021: 0.47%) in the most severe scenario. Both scenarios represent a low proportion of the Company's loan portfolio.

- Subsidence

In the 2030's, at the Company level the percentage of properties predicted to experience subsidence is expected to increase from 0.39% (2021: 0.39%) in the least severe scenario to 0.42% (2021: 0.41%) in the most severe scenario. The outcome of both scenarios represents a low proportion of the Company's loan portfolio.

- Coastal erosion

There are two elements to coastal erosion risk. The first relates to the proximity of the property to the coast. The second depends on whether the area in which the property is located is likely to experience coastal erosion in the future.

The Company has over 93% of the loan portfolio more than 1,000 metres from the coastline, indicating a very low coastal erosion risk.

The Company has 32 properties within 100 metres of the coastline where coastal erosion is likely to be experienced in the future.

c) Energy Performance Certificate profile

The EPC profile of the Company follows a similar trend to the national average. At the Company level 39% (2021: 37%) of properties have an EPC of C or better, 46% (2021: 47%) have an EPC of D, with 13%(2021: 15%) in E and negligible percentages in F or G. 90% of the properties supporting the Company's loan portfolios have the potential to have at least an EPC rating of C.

Value at Risk assessment

The Value at Risk to the Company, measured through change to Expected Credit Losses (ECL) and Standardised and Internal Ratings-Based (IRB) Risk Weighted Assets (RWAs), is assessed through the application of stress to collateral valuations as per the methodology outlined below. Impacts are assessed against the latest year end position.

Risk review (continued)

Management of climate change risk (continued)

Climate change scenarios

To get the full range of impacts, the most and least severe climate change stress scenarios were considered.

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

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

Methodology – physical risks

For the physical risks, updated valuations are produced to reflect the impact of a flood, subsidence and coastal erosion risk.

Methodology – transitional risks

The Company's expectation is that, under the early action scenario (RCP 2.6), the government will require all properties to achieve EPC A, B and C grades where possible. This risk was considered for BTL accounts only.

d) Analysis outcome

The physical risks currently present an immaterial ECL or capital risk to the Company. The sensitivity to transitional risk is larger than that of physical risk, although still very small, particularly when considering the aggressive time frames on government policy relating to minimum EPC requirements.

e) Planned enhancements during 2023

In the future, the Company's climate risk data and scenario analysis capabilities will continue to be enhanced.

Principal risks and uncertainties

The Company's activities expose it to a number of financial risks and uncertainties, primarily credit risk, liquidity and funding risk, market risk, business risk, operational risk and assurance of compliance with regulations which are explained in more detail below and in note 35.

The impact of the rising cost of living, the cost of borrowing and the prospect of further increases in the BoE base rate were a key area of focus for the Company. The Company conducted additional analysis and made adjustments to the macroeconomic scenarios used in its modelling and provisioning to ensure the impacts on customer affordability were covered.

The Group remained alert to the heightened cyber risk environment driven by the situation in Ukraine and the embedding of the hybrid working model for colleagues across the Group. Our cyber security capabilities remained appropriate through continued investment and frequent penetration testing.

The Company experienced some operational challenges during 2022. The number of base rate rises was responsible for strong demand for savings accounts and the number of product rate changes required was operationally challenging. In the second half the market saw an increasing level of borrowers/customers looking to refinance with their existing lender and in some cases refinance early to avoid anticipated future interest rate rises. This caused a spike in enquiries and applications.

The Group continues to focus on enhancing forecasting and stress testing capabilities, with a particular focus on IRB stress testing and stress testing using Basel 3.1 scenarios.

The Company continued to embed its approach to managing climate risk through the further development of its climate risk management framework.

Credit risk

Credit risk is the risk of financial loss arising from the failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.

Credit risk arises on the Company's financial assets consisting of investments in debt securities, loans and advances to customers, derivative financial instruments, trade and other receivables, loans and advances to credit institutions and loan commitments.

Borrowers may encounter idiosyncratic problems in repaying their loans, for example loss of a job or execution problems with a development project. While in most cases of default the Company's lending is secured, some borrowers may fail to maintain the value of the security, which may result in a loss being incurred. A robust underwriting assessment, using an automated scorecard approach, is undertaken to ensure that a customer has the ability and propensity to repay and sufficient security is available to support the new loan requested. Should there be problems with a loan, the Collections and Recoveries team works with customers who are unable to meet their loan service obligations to reach a satisfactory conclusion while adhering to the principle of treating customers fairly. The strategic focus on lending to professional landlords means that properties are likely to be well managed, with income from a diversified portfolio mitigating the impact of rental voids or maintenance costs. Lending to owner-occupiers is subject to a detailed affordability assessment, including the borrower's ability to continue payments if interest rates increase. The drivers of borrower default risk have shifted to rising inflation and consequent increases in interest rates impacting affordability for accounts which revert onto higher interest rates and an increasing risk of borrower default.

Principal risks and uncertainties (continued)

Credit risk (continued)

A broad deterioration in the UK economy would adversely impact both the ability of borrowers to repay loans and the value of the Company's security. Credit losses would impact the Company's lending portfolios, even if individual impacts were to be small, the aggregate impact on the Company could be significant. The Company works within portfolio limits on LTV, affordability, name, sector and geographic concentration that are approved by the Company Risk Committee and the Board. These are reviewed on a semi-annual basis. In addition, stress testing is performed to ensure that the Company maintains sufficient capital to absorb losses in an economic downturn and continues to meet its regulatory requirements. The uncertain economic outlook and the ongoing geopolitical risk due to the conflict in Ukraine resulted in high inflation and increases in interest rates could drive higher levels of customer defaults, rising impairment levels and falling residential and commercial collateral values.

Wholesale credit risk is managed by ensuring treasury counterparties are subject to ALCO approval, and continue to meet minimum external credit ratings. Exposures to single counterparties are assigned and monitored on an ongoing basis against the underlying instruments, such as cash or derivative exposures which are used to manage risk, or provide liquidity.

Expected Credit Losses

The Company recognises ECL based on unbiased forward-looking information. The impairment model applies to all financial assets at amortised cost, debt financial assets at fair value through other comprehensive income and loan commitments.

A summary of the key impairment charge drivers during 2022 included:

a. Macroeconomic outlook – positive House Price Index (HPI) movements and continued low unemployment were observed throughout 2022, however, the outlook has deteriorated towards the end of the year due to the war between Russia and Ukraine and the fallout from the mini budget resulted in increases in interest rates and inflation. The economic outlook at the end of 2022 was driven by the rising interest rates, higher than target inflation and most notably a decrease in house prices. The change in economic outlook has contributed £1.9m of impairment charge in 2022 whilst the improvement in house prices has driven a release of £3.3m.

b. Model and staging enhancements – enhancements were made to the Company's underlying models to ensure estimates continued to reflect actual credit profile performance. Most notably, the Company's enhancements to models as part of the IRB programme were incorporated into the Company's IFRS 9 framework. In addition, the Company adopted a primary significant increase in credit risk driver of a change in default risk sensitive to economic outlook. The cumulative impact of these modelling and staging enhancements was a £2.9m release for 2022.

c. Post-model adjustments – the Company adopted a number of post-model adjustments predominantly to account for external risks that were not sufficiently addressed in the model and staging framework. The most significant were adjustments made to account for cost of borrowing and cost of living stresses due to the sharp increases in interest rates and the historically high inflation. In total, the post-model adjustments contributed £5.9m of impairment charge in 2022.

d. Credit profile provision charges - impairment charges driven by changes in the credit profile such as portfolio size, portfolio mix and changes in staging mix totalled £7.1m.

Principal risks and uncertainties (continued)

Credit risk (continued)

Macroeconomic scenarios

The measurement of ECL under the IFRS 9 approach is complex and requires a high level of judgement. The approach includes the estimation of probability of default (PD), loss given default (LGD) and exposure at default (EAD). An assessment of the maximum contractual period with which the Company is exposed to the credit risk of the asset is also undertaken.

IFRS 9 requires firms to calculate ECL allowances simulating the effect of a range of possible economic outcomes, calculated on a probability weighted basis. This requires firms to formulate forward-looking macroeconomic forecasts and incorporate them in ECL calculations.

i. How macroeconomic variables and scenarios are selected

During the IFRS 9 modelling process the relationship between macroeconomic drivers and arrears, default rates and collateral values is established. For example, if unemployment levels increase the Company would observe an increasing number of accounts moving into arrears. If residential property prices fall the risk of losses being realised on the sale of a property would increase. The Company adopted an approach which utilises four macroeconomic scenarios. These scenarios are provided by an industry leading economics advisory firm that provide management and the Board with advice.

A base case forecast is provided, along with a plausible upside scenario. Two downside scenarios are also provided (downside and a severe downside).

ii. How macroeconomic scenarios are utilised within ECL calculations

PD estimates are either scaled up or down based on the macroeconomic scenarios utilised.

LGD estimates are impacted by property price forecasts which are utilised within loss estimates should an account be possessed and sold.

EAD estimates are not impacted by the macroeconomic scenarios utilised.

Each of the above components are then directly utilised within the ECL calculation process.

iii. Macroeconomic scenario governance

The Company has a robust governance process to oversee macroeconomic scenarios and probability weightings used within ECL calculations.

On a periodic basis the Group's Risk function and external economic adviser provide the Company's Risk and Audit Committees with an overview of recent economic performance, together with updated base, upside and two downside scenarios. The Risk function conducts a review of the scenarios comparing them to other economic forecasts, which results in a proposed course of action which, once approved, is implemented.

iv. Changes made during 2022

Throughout 2022, the scenario suite was monitored and updated as UK political and geopolitical developments occurred.

Principal risks and uncertainties (continued)

Credit risk (continued)

The Company's Risk and Audit Committees focused on assessing whether specific risks had been captured within externally provided forward looking forecasts. Of particular focus were the risks relating to rising costs of living and subsequent rising interest rates to control inflation levels. The Group undertook a detailed analysis to assess the portfolio risks and consider whether these were adequately accounted for in the IFRS 9 models and frameworks, and identified a number of areas requiring post-model adjustments, most notably to account for the increased credit risk from the heightened cost of living and cost of borrowing resulting in an increase in the balance of accounts in stage 2.

The Board reflected on the ongoing appropriateness of probabilities attached to the suite of IFRS 9 scenarios as the macroeconomic outlook evolved throughout the year. Scenarios were adjusted to a symmetrical probability, where the upside and downside scenarios carry equal weightings, as a result of separate PMA's being raised to ensure that the current IFRS 9 framework adequately provisioned the underlying portfolio risk.

Details relating to the scenarios utilised to set the 31 December 2022 IFRS 9 provision levels are provided in the table below.

			Scenario %				
Scenario	Probability weighting (%)	Economic measure	Year end 2022	Year end 2023	Year end 2024	Year end 2025	Year end 2026
Base case	40	GDP	4.3	(0.7)	1.8	2.7	2.1
		Unemployment	3.7	4.7	4.2	3.9	3.8
		House Price growth	9.0	(9.0)	(3.4)	2.8	5.8
		CPI	10.7	3.4	2.0	1.6	1.2
		Bank Base Rate	2.8	4.0	3.6	2.6	1.8
Upside	30	GDP	4.6	1.9	2.9	3.4	2.2
		Unemployment	3.6	4.2	4.0	3.7	3.7
		House Price growth	10.6	(6.7)	(1.3)	4.4	5.6
		CPI	11.0	4.7	2.9	1.4	1.1
		Bank Base Rate	3.0	5.3	4.8	3.4	2.3
Downside	20	GDP	3.7	(4.4)	1.0	2.4	2.1
		Unemployment	4.2	6.3	7.0	7.0	6.7
		House Price growth	6.8	(14.4)	(8.0)	(1.2)	6.1
		CPI	10.2	1.6	1.5	1.8	0.8
		Bank Base Rate	2.9	3.8	3.1	1.9	1.3
Severe downside	10	GDP	3.2	(7.5)	0.1	1.9	2.1
		Unemployment	4.3	6.8	7.6	7.6	7.2
		House Price growth	5.0	(18.6)	(12.1)	(5.0)	6.5
		CPI	9.5	0.7	0.9	2.1	0.5
		Bank Base Rate	2.6	2.8	2.0	0.6	0.5

Principal risks and uncertainties (continued)

Credit risk (continued)

Forbearance

Where a borrower experiences financial difficulties, which impacts their ability to service their financial commitments under the loan agreement, forbearance may be used to achieve an outcome which is mutually beneficial to both the borrower and the Company.

By identifying borrowers who are experiencing financial difficulties pre-arrears or in arrears, a consultative process is initiated to ascertain the underlying reasons and to establish the best course of action to enable the borrower to develop credible repayment plans to see them through the period of financial stress.

The specific tools available to assist customers vary by product and the customers' circumstances. The various options considered for customers are as follows:

- Temporary switch to interest only: a temporary account change to assist customers through periods of financial difficulty where arrears do not accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.
- Interest rate reduction: the Company may, in certain circumstances, where the borrower meets the required eligibility criteria, transfer the mortgage to a lower contractual rate. Where this is a formal contractual change the borrower will be requested to obtain independent financial advice as part of the process.
- Loan term extension: a permanent account change for customers in financial distress where the overall term of the mortgage is extended, resulting in a lower contractual monthly payment.
- Payment holiday: a temporary account change to assist customers through periods of financial difficulty where arrears accrue at the original contractual payment. Any arrears existing at the commencement of the arrangement are retained.
- Voluntary-assisted sale: a period of time is given to allow borrowers to sell the property and arrears accrue based on the contractual payment.
- Reduced monthly payments: a temporary arrangement for customers in financial distress. For example, a short-term arrangement to pay less than the contractual payment. Arrears continue to accrue based on the contractual payment.
- Capitalisation of interest: arrears are added to the loan balance and are repaid over the remaining term of the facility or at maturity for interest only products. A new payment is calculated, which will be higher than the previous payment.
- Full or partial debt forgiveness: where considered appropriate, the Company will consider writing off part of the debt. This may occur where the borrower has an agreed sale and there will be a shortfall in the amount required to redeem the Company's charge, in which case repayment of the shortfall may be agreed over a period of time, subject to an affordability assessment or where possession has been taken by the Company, and on the subsequent sale where there has been a shortfall loss.

Principal risks and uncertainties (continued)

Credit risk (continued)

- Arrangement to pay: where an arrangement is made with the borrower to repay an amount above the contractual monthly instalment, which will repay arrears over a period of time.
- Promise to pay: where an arrangement is made with the borrower to defer payment or pay a lump sum at a later date.
- Bridging loans which are more than 30 days past their maturity date. Repayment is rescheduled to receive a balloon or bullet payment at the end of the term extension where the institution can duly demonstrate future cash flow availability.

The Company aims to proactively identify and manage forborne accounts, utilising external credit reference bureau information to analyse PD and customer indebtedness trends over time, feeding pre-arrears watch list reports. Watch list cases are in turn carefully monitored and managed as appropriate.

Further information regarding forbearance can be found in note 35 to the financial statements.

Fair value of collateral methodology

The Company ensures that security valuations are reviewed on an ongoing basis for accuracy and appropriateness. Residential properties are indexed at least quarterly using HPI data.

Solvency risk

Solvency risk is the risk of the potential inability of the Company to ensure that it maintains sufficient capital levels for its business strategy and risk profile under both the base and stress case financial forecasts.

The Company maintains an appropriate level and quality of capital to support its prudential requirements with sufficient contingency to withstand a severe but plausible stress scenario. The solvency risk appetite is based on a stacking approach, whereby the various capital requirements (Pillar 1, Individual Capital Guidance (ICG), Capital Requirement Directive and Regulation (CRD) IV buffers, Board and management buffers) are incrementally aggregated as a percentage of available capital (CET1 and total capital).

Solvency risk is a function of balance sheet growth, profitability, access to capital markets and regulatory changes. The Company actively monitors all key drivers of solvency risk and takes prompt action to maintain its solvency ratios at acceptable levels. The Board and management also assess solvency when reviewing the business plans and inorganic growth opportunities.

The Company’s fully-loaded CET1 and total capital ratios under CRD IV reduced to 18.8% and 20.2% respectively as at 31 December 2022 (31 December 2021: 20.0% and 21.7%, respectively) with dividend distributions supporting the Group’s share buyback programme, interim and final dividends. CET 1 remains strong demonstrating the strong organic capital generation capability of the business, the impact of the regulatory support measures and prudent management of the credit risk profile. The Company’s leverage ratio was 7.9% as at 31 December 2022 (31 December 2021: 8.3%).

Principal risks and uncertainties (continued)

Liquidity and funding risk

Liquidity risk is the risk that the Company fails to meet its financial obligations as they fall due; funding risk is the adverse impact of higher funding costs and/or lack of available funds on the Company's cash flow.

The Company has a prudent approach to liquidity management through maintaining sufficient liquidity resources to cover cash flow imbalances and fluctuations in funding under both normal and stressed conditions, arising from market-wide and Bank-specific events. The Company's liquidity risk appetite has been calibrated to ensure that it always operates above the minimum prudential requirements with sufficient contingency for unexpected stresses, whilst actively minimising the risk of holding excessive liquidity which would adversely impact the financial efficiency of the business model.

The Company continues to attract new retail savers and has high retention levels with existing customers. In addition, the Company has a range of wholesale funding options, including securitisation issuances and use of retained notes.

The Company actively managed its liquidity and funding profile within the confines of the risk appetites as set out in the Company's ILAAP.

Retail funding rates increased throughout the year due to the significant increase in BoE Base rate. However, swap rate increases during the year allowed the Company to retain more margin on savings rates offered to customers. There was a short period towards the end of the first quarter where retail funding was volatile as the first of the larger Base rate increases pushed competitor savings rates higher and increased competition, however the Company was able to attract new depositors with competitive rates.

Swap rate increases in 2022 also led to the Company receiving a high level of variation margin collateral on the Company's interest rate swaps. The Company has increased internal buffers to ensure that sufficient funds are held at the BoE to meet any swap margin calls that may arise if swap rates reduce.

The Company's risk appetite is based on internal stress tests that cover a range of scenarios and time periods and therefore are a more severe measure of resilience to a liquidity event than the standalone liquidity coverage ratio (LCR). As at 31 December 2022, the Company had a LCR of 148% (2021: 158%), significantly above regulatory requirements.

Market risk

The Company proactively manages its risk profile in respect of adverse movements in interest rates and counterparty exposures.

The Company manages interest rate risk and basis risk as a consequence of structural mismatches between fixed rate mortgage lending, fixed term savings and the maintenance of a portfolio of high quality liquid assets. Interest rate exposure is mitigated on a continuous basis through portfolio diversification, reserve allocation and the use of financial derivatives within limits set by the ALCO and approved by the Board.

The Company's balance sheet is completely pound sterling (GBP) denominated. Wholesale counterparty risk is measured on a daily basis and constrained by counterparty risk limits.

Principal risks and uncertainties (continued)

Operational risk

The Company continues to adopt a proactive approach to the management of operational risks. The operational risk management framework has been designed to ensure a robust approach to the identification, measurement and mitigation of operational risks, utilising a combination of both qualitative and quantitative evaluations. The Company's operational processes, systems and controls are designed to minimise disruption to customers, damage to the Company's reputation and any detrimental impact on financial performance. The Company actively promotes the continual evolution of its operating environment.

Where risks continue to exist, there are established processes to provide the appropriate levels of governance and oversight, together with an alignment to the level of risk appetite stated by the Board. The Company continues to invest in improving the resilience of its core infrastructure. It has identified its prioritised business services and the infrastructure that is required to support them. Tests are performed regularly to validate its ability to recover from an incident. Whilst progress was made in reducing both the likelihood and impact of an IT failure, the risks remain, in particular due to the new hybrid working arrangement. Further work is planned during 2023. The Company has planned enhancements to internal IT access controls to address control deficiencies identified by Internal and external audit. The systems of internal control and risk management have been in place throughout the year under review and up to the date of approval of the Annual Report and Accounts.

A strong culture of transparency and escalation has been cultivated throughout the organisation, with the Operational Risk function having a Group-wide remit, ensuring a risk management model that is well embedded and consistently applied. In addition, a community of Risk Champions representing each business line and location has been identified. Operational Risk Champions ensure that the operational risk identification and assessment processes are established across the Company in a consistent manner. Risk Champions are provided with appropriate support and training by the Operational Risk function.

A hybrid working model has been adopted across the Company, with the exception being front-line customer-facing colleagues, following the return to office post the COVID-19 pandemic. With a high number of employees working and accessing systems from home the risk of a cyber-attack has heightened. Whilst IT security risks continue to evolve, work continues to enhance the level of maturity of the Group's controls and defences, supported by dedicated IT security experts. The Group's ongoing penetration testing continues to drive enhancements by identifying potential areas of risk.

Regulatory and compliance risk

The Company is committed to the highest standards of regulatory conduct and aims to minimise breaches, financial costs and reputational damage associated with non-compliance.

The Company has an established Compliance function which actively identifies, assesses and monitors adherence with current regulation and the impact of emerging regulation.

In order to minimise regulatory risk, the Company maintains a proactive relationship with key regulators, engages with industry bodies such as UK Finance and seeks external expert advice. The Company also assesses the impact of incoming regulation on itself and the wider market in which it operates, and undertakes robust assurance assessments from within the Risk and Compliance functions.

Conduct risk

The Company considers its culture and behaviour in ensuring the fair treatment of customers and in maintaining the integrity of the market segments in which it operates to be a fundamental part of its strategy and a key driver to sustainable profitability and growth. The Company does not tolerate any systemic failure to deliver fair customer outcomes.

Principal risks and uncertainties (continued)

On an isolated basis, incidents can result in detriment owing to human and/or operational failures. Where such incidents occur they are thoroughly investigated, and the appropriate remedial actions are taken to address any customer detriment and to prevent recurrence.

The Company considers effective conduct risk management to be a product of the positive behaviour of all employees, influenced by the culture throughout the organisation and therefore continues to promote a strong sense of awareness and accountability.

Financial crime risk

The Company operates in a low risk environment providing relatively simple products to UK domiciled customers serviced through a UK registered bank account. The Company has an established screening programme that is deployed at the point of origination and on a regular basis throughout the customer lifecycle.

The Company continues to invest in a range of systems and controls that are deployed across its product range in order to detect and prevent the exposure to fraud through the customer lifecycle. All new to business applications are subject to a range of controls to identify and mitigate fraud. Customer activity is monitored in order to detect suspicious activity or behaviour that may be indicative of fraud.

Strategic and business risk

The Board has clearly articulated the Company's strategic vision and business objectives supported by performance targets. The Company does not intend to undertake any medium to long-term strategic actions, which would put the Company's strategic or financial objectives at risk.

To deliver against its strategic objectives and business plan, the Company has adopted a sustainable business model based on a focused approach to core niche market sub-segments where its experience and capabilities give it a clear competitive advantage.

The Company remains highly focused on delivering against its core strategic and financial objectives, against a highly competitive and uncertain backdrop.

Reputational risk

Reputational risk can arise from a variety of sources and is a second order risk – the crystallisation of another principal risk can lead to a reputational risk impact.

The Company monitors reputational risk through tracking media coverage, customer satisfaction scores, the share price and net promoter scores provided by brokers.

Principal risks and uncertainties (continued)

Emerging risks

Emerging risks with a description of the risk and the mitigating actions are also included within the OSBG Annual Report and Accounts, and include political and macroeconomic uncertainty, climate change, model risk and regulatory change which are expanded on below.

Political and macroeconomic uncertainty

The Company's lending activity is focused in the United Kingdom and, as such, will be impacted by any risks emerging from changes in the macroeconomic environment. Rising inflation and interest rates pose risks to the Company's loan portfolio performance.

The Company has mature and robust monitoring processes and via various stress testing activities (i.e. ad hoc, risk appetite, ICAAP and ILAAP) understands how the Company performs over a variety of macroeconomic stress scenarios and has developed a suite of early warning indicators, which are closely monitored to identify changes in the economic environment. The Board and management review detailed portfolio reports to identify any changes in the Company's risk profile.

Climate change

As the worldwide focus on climate change intensifies, both the physical risks and the transitional risks associated with climate change continue to grow. Climate change risks include:

- physical risks which relate to specific weather events, such as storms and flooding, or to longer-term shifts in the climate, such as rising sea levels. These risks could include adverse movements in the value of certain properties that are in coastal and low lying areas, or located in areas prone to increased subsidence and heave;
- transitional risks may arise from the adjustment towards a low-carbon economy, such as tightening energy efficiency standards for domestic and commercial buildings. These risks could include a potential adverse movement in the value of properties requiring substantial updates to meet future energy performance requirements;
- reputational risk arising from a failure to meet changing societal, investor or regulatory demands.

Climate change risk is managed on behalf of the Company by the Group. During 2022, the Group further embedded its approach to climate risk management, which included the development of a climate risk appetite, and making enhancements to its Task Force on Climate-related Financial Disclosures (TCFD).

The Group's Chief Risk Officer has designated senior management responsibility for the management of climate change risk.

Principal risks and uncertainties (continued)

Emerging risks (continued)

Model risk

The risk of financial loss, adverse regulatory outcomes, reputational damage or customer detriment resulting from deficiencies in the development, application or ongoing operation of models and ratings systems.

The Company also notes changes in industry best practice with respect to model risk management including a PRA consultation paper containing proposed expectations regarding the Company's management of model risk.

The Company has well-established model risk governance arrangements in place, with Board and Executive Committees in place to ensure robust oversight of the Company's model risk profile. Dedicated resources are in place to ensure model governance arrangements continue to meet any changes in industry and regulatory expectations.

Regulatory change

The Company remains subject to high levels of regulatory oversight and an extensive and broad ranging regulatory change agenda, including meeting the requirements of the Resolvability Assessment Framework and Operational Continuity in Resolution. The Company is therefore required to respond to prudential and conduct related regulatory changes, taking part in thematic reviews as required. There is also uncertainty in relation to the regulatory landscape post the United Kingdom's exit from the European Union.

The Company has established horizon scanning capabilities, coupled with dedicated prudential and conduct regulatory experts in place to ensure the Company manages future regulatory changes effectively.

The Company also has strong relationships with regulatory bodies, and via membership of UK Finance inputs into upcoming regulatory consultations.

Section 172 statement

The Directors are bound by their duties under section 172(1)(a) to (f) of the Companies Act 2006 and the manner in which these have been discharged; in particular their duty to act in the way they consider, in good faith, promotes the success of the Company for the benefit of its members as a whole.

The stakeholders which the Directors considered in this regard are customers, intermediaries, colleagues, suppliers, regulators and the local communities in which we are located. These stakeholders are considered to be those most likely to be impacted by decisions taken by the Board. The pages that follow set out how Directors complied with the requirements of section 172 during the year.

Stakeholder engagement

The Board is committed to continually maintaining effective engagement and active dialogue with its stakeholders and ensuring that stakeholder views and interests are a key consideration in the Board's decision making. This year, the Board continued to formalise its approach to ESG during the year, through the embedding of the Group's ESG Strategy and Operating Framework, and ensuring that it further improved our customers' experience by putting their needs first.

The Company is committed to building strong relationships with all of our stakeholders as they fulfil their duty to promote the success of the Company under section 172 of the Companies Act 2006. Below we outline how the Company engaged with its key stakeholders during the year.

Customers

The Company prides itself on building strong, long-term relationships with our customers. Our continued commitment to providing excellent service to borrowers and savers remained a priority in 2022 in light of the cost of living and borrowing.

We offer our savers an opportunity to let us know how we are doing whenever they call or interact with us by listening to their views and acting upon what they tell us. Customer feedback is collected throughout the year and satisfaction scores produced as a result, with a savings net promoter score (NPS) of +61 (2021: +71) for Charter Savings Bank. During 2022, as the interest rates continued to rise, we saw a significant increase in the volume of calls from our savers wishing to benefit from attractively priced savings products and our borrowers who were concerned about the rising cost of borrowing. As a result, there was a decrease in the savings and the broker NPSs compared to 2021. Service levels have since improved and they remain our key focus.

The Board's engagement with customers is indirect and Directors are kept informed of customer-related matters through regular reports, feedback and research. Satisfaction scores and retention rates, together with the number of complaints and resolution times, form part of the management and Board monthly reporting packs, ensuring the visibility of our customers' experiences. Customer satisfaction scores form the basis of new initiatives and actions which continually improve customer experience. The Board was kept informed regarding the treatment of and support offered to customers who require additional support.

Customers and intermediaries may be consulted when the business is considering the launch of a new product to ensure it meets their needs and any concerns raised are addressed.

Section 172 statement (continued)

Intermediaries

Our lending products are distributed via mortgage brokers. Mortgage brokers and landlords are vital to our success; it is important for us to understand the challenges they face and what they are trying to achieve in terms of serving their customers, so we can adapt the way in which we support them, to provide an even better service.

The Board's engagement with intermediaries is indirect and Directors are kept informed of customer-related matters through regular updates at Board meetings. Broker and borrower satisfaction scores are tracked on a regular basis, along with details of all complaints, and are reviewed by the Board and management within monthly reporting packs.

The Company prides itself in providing a unique and consistent lending proposition, which fulfils its goal of making it easier for intermediaries to serve their customers, the Company's borrowers. Regular engagement with the broker community extends beyond our propositions and enables us to continuously enhance the service we provide, with our business development managers listening and working closely with intermediaries to discuss cases and helping to obtain swift and reliable decisions.

The Group's Sales teams participated in 330 physical and virtual intermediary events, during 2022, interacting with brokers and keeping abreast of industry developments and intermediary requirements. The Company's mortgage broker NPS remained high at +39 in 2022 (2021: +42).

Employees

The Company has no employees (2021: none) as all operational services have been formally contracted to other subsidiaries of OSBG, the Company's ultimate parent company. OSBG favours interactive communication between management and employees and regularly asks for their opinions in the Group-wide surveys. The key topics at the forefront of the Board's mind in 2022 was the change in the ways of working after the pandemic on employees' lives, both professionally and personally in terms their well-being and mental health, and the effect of the increased cost of living.

Regulators

The Board recognises the importance of having an open and continuous dialogue with all regulators, as well as other government bodies, trade associations and UK Finance.

The Company maintains a proactive dialogue with the PRA and Financial Conduct Authority (FCA). Engagement typically takes the form of regular and ad hoc meetings attended by both members of the Board and Executives, as well as subject matter experts.

The Company also regularly interacts and has constructive relationships with the BoE and HM Revenue & Customs (HMRC), among others, which helps to ensure that the Company is aligned with the relevant regulatory frameworks and that the business is engaged with issues impacting the financial services industry.

Community

The Company is heavily involved in the West Midlands community, sponsoring local sports teams and supporting local charities. Engagement with the community saw the total amount donated to charity partners and good causes by the wider Group and employees in the year achieve donations of nearly £225k.

Section 172 statement (continued)

Environment

The Company is committed to operating sustainably and to continually reducing our environmental impact by not only promoting awareness of environmental issues among our employees, but also by adhering to our plan to become a greener organisation.

The Board is responsible for encouraging and overseeing an environmentally-friendly culture and ensuring that the business is ready to respond to the growing impact of climate change on the Company's activities and enhanced regulation.

Decision-making

The Board recognises that considering our stakeholders in key business decisions is fundamental to our ability to deliver the Company's strategy in line with our long-term values and operating the business in a sustainable way. Balancing the needs and expectations of our key stakeholders has been at the forefront of the Board's thinking and has been more important than ever during 2022, as a result of the economic environment and the rising cost of living. The Board acknowledges that some decisions will result in different outcomes for each stakeholder.

Key strategic decisions in the year

Landlord Leaders

The Board received updates on progress in relation to the Group's Landlord Leaders initiative during joint Board meetings of the Company and the Group Board. Following engagement with landlords and brokers, and as part of its commitment to helping customers prosper, the Group has committed to delivering a number of initiatives to support the building of a future-focused sustainable industry.

The Group has pledged £50m of funding to the newly established Landlord Leader Fund to help landlords enhance energy efficiency. Other initiatives include the launch of new products to support landlords with refurbishing their properties, redesigning the underwriting process and partnering with tax specialists to provide advice and guidance on tax planning for part-time landlords looking to professionalise. As part of this commitment, the Group will create a new Landlord Leaders community to bring brokers, landlords and other industry members together.

Customer experience

The Board was kept informed of a number of enhancements made to the customer journey. In particular, the launch of a new, simplified product range which was proactively communicated to customers to ensure that they had sufficient time to take action prior to the end of their fixed period. Additional resource was allocated to improve the customer experience, including following up with customers who had not taken action upon entering the reversion period.

In addition, enhancements were made to the Company's eligibility criteria to enable more customers to take advantage of the revised rates in order to minimise payment shocks and redemptions.

Key performance indicators (KPIs)

In pursuing its strategy, the Company aims to deliver high quality growth and sustainable and attractive risk-adjusted returns. Non-financial KPIs, including savings NPS and mortgage broker NPS, are included in the Section 172 statement above. The Company seeks to accomplish its aims by maintaining balance and delivering success across its key goals:

Strategic goal	KPIs	2022	2021
Loan Book Growth	Originations (number) (1)	15,785	12,078
Deliver sustainable balance sheet growth	Loan book (£m) (1)	10,260.9	8,789.3
Risk management	Cost of risk (2)	0.09%	-0.10%
Maintain disciplined risk management	CET1 (3)	18.8%	20.0%
Profitability	Net interest income (£m) (4)	303.5	230.0
Conduct rigorous margin management	Cost income ratio (5)	21.6%	26.7%
Shareholders Deliver shareholder value	Return on equity (6)	21.7%	17.7%

(1) Number of mortgage and loan originations and loan book growth

These measures enable management to monitor and control the growth of this business activity throughout the year. Originations increased 31% in the year and reflected continued overall growth of the mortgage loan book. Performance across all segments was supported by continued successful new product development that addressed changing customer needs and regulatory requirements.

(2) Cost of risk

Impairment charge or release per the Statement of Comprehensive Income as a percentage of the mortgage assets as a thirteen point average (the average loans and advances to customers balances is calculated as the sum of the opening and closing balances for the year and the balances at each month end during the year divided by 13).

This is the cost of managing risks and incurring losses. The ratio increased during the year primarily driven by more severe macroeconomic scenarios and post model adjustments (PMA) to account for the rising cost of living and borrowing as well as the strong growth in loan book in the year.

(3) CET1 (Common Equity Tier 1 capital)

A measure of the capital strength. The highest quality form of regulatory capital that comprises total shareholders’ equity and certain other regulatory adjustments. The CET1 ratio reduced but remains strong and meets all regulatory requirements.

Key performance indicators (KPIs) (continued)

(4) Net interest income = interest receivable and similar income less interest payable and similar charges

As the key revenue stream for the business is from the interest income from customer mortgages, the NII is a key figure that management use to assess the performance of the Company. On a monthly basis the NIM is monitored for the different types of mortgage assets; BTL, homeowner, short-term bridging and second charge revenue streams. NII continues to grow as a result of the continued growth of the mortgage loan book and improving margins.

(5) Cost income ratio

Administrative expenses as a percentage of total income as set out in the Statement of Comprehensive Income.

The cost income ratio has decreased. This reflects the benefits of higher income, including the £42.2m fair value gains on financial instruments, in the year and economies of scale on the cost lines.

(6) Return on equity = profit for the year as a percentage of equity

Profit for the year expressed as a percentage of equity.

Equity being share capital and reserves per the Statement of Financial Position.

The purpose of this measure is to show how efficiently the Company is making use of resources available to it.

Return on equity increased during 2022 due to strong profitability in the year.

Environment

The Company, as part of OSBG, have the same ambition to tackle the operational emissions from our buildings and the more challenging emissions associated with the properties we lend on (financed emissions). The commitment was supported by two targets that guide our actions:

1) Committing to net zero for our operational emissions by 2030

2) Committing to net zero for our total operational and financed emissions by 2050

Our approach to mitigating climate change and delivering on the opportunities this presents is in line with our Purpose and Values.

In recognition of the importance placed on addressing climate change, “Just Transition” is a strategic ESG pillar of our ESG strategy set by OSBG.

OSBG’s Transition Plan will set out the Company’s interim and long term targets and the actions it will take over the short and medium term in order to make progress towards our ambitions.

Further details are set out in the OSBG annual report and accounts ESG Framework and Environment reports.

Approval

This report was approved by the Board of Directors and signed on its behalf by:

[redacted]

David Morgan
Company Secretary
04 April 2023

2 Charter Court, Broadlands,
Wolverhampton,
West Midlands,
WV10 6TD
Registered number: 06749498

The Directors present their Report, together with the audited Financial Statements and Auditor's Report, for the year ended 31 December 2022.

Information presented in other sections

Information relating to future developments, dividends, employees, principal risks and uncertainties, and section 172 and how the Directors considered and engaged with stakeholders are included in the Strategic Report. Information on derivative financial instruments can be found in note 19, for information on risk management see note 35.

The Company recognised research and developments costs in the year (note 23) relating to development of an internal model which will help to calculate risk weightings for regulatory capital purposes and help the Company optimise capital allocation. Once approved by the PRA, this will replace the standard calculation approach and should help the Company to be capital efficient and improve credit risk management capability.

Going concern statement

The Board undertakes regular rigorous assessments of whether the Company is a going concern in light of current economic conditions and all available information about future risks and uncertainties.

In assessing whether the going concern basis is appropriate, projections for the Company and the wider Group have been prepared, covering its future performance, capital and liquidity for a period in excess of 12 months from the date of approval of these financial statements. These forecasts have been subject to sensitivity tests, including stress scenarios, which have been compared to the latest economic scenarios provided by the Group's external economic advisors, as well as reverse stress tests.

The assessments include the following:

- Financial and capital forecasts were prepared under stress scenarios which were assessed against the latest economic forecasts provided by the Group's external economic advisors. Reverse stress tests were also run, to assess what combinations of HPI, unemployment, default rates and consumer price index variables would result in the Company utilising its regulatory capital buffers in full and breaching the Company's minimum prudential requirements along with analysis and insight from the Company's ICAAP. The Directors assessed the likelihood of those reverse stress scenarios occurring within the next 12 months and concluded that the likelihood is remote.

- The latest liquidity and contingent liquidity positions and forecasts were assessed against the ILAAP stress scenarios, with the Company maintaining sufficient liquidity throughout the going concern assessment period.

- The Company continues to assess the resilience of its business operating model and supporting infrastructure in the context of the emerging economic, business and regulatory environment. The key areas of focus continues to be on the provision of the Company's important business services, minimising the impact of any service disruptions on the Company's customers or the wider financial services industry. The Company's response to the COVID-19 pandemic demonstrated the inherent resilience of the Company's critical processes and infrastructure and its agility in responding to changing operational demands. The Company recognises the need to continually invest in the resilience of its services, with specific focus in 2023 on ensuring that the third parties on which it depends have the appropriate levels of resilience and in further automating those processes that are sensitive to increases in volume.

The Company's financial projections demonstrate that the Company has sufficient capital and liquidity to continue to meet its regulatory requirements as set out by the PRA.

The Board has therefore concluded that the Company has sufficient resources to continue in operational existence for a period in excess of 12 months from the date of this report and as a result, it is appropriate to prepare these financial statements on a going concern basis.

Directors

The Directors who served during the year and to the date of this report were as follows:

Graham Allatt*
Rodney Duke*
Andrew Golding
Noël Harwerth*
Rajan Kapoor*
April Talintyre
Simon Walker* (appointed 4 January 2022)
*Independent Non-Executive Director

None of the Directors had any interest either during or at the end of the year in any material contract or arrangement with the Company.

With effect from the OSBG AGM on 11 May 2023 Graham Allatt will no longer be a member of the CCFSL Board, Audit Committee or Risk Committee.

Jason Elphick was the Company Secretary during the year and until 1 March 2023. The Company Secretary from 1 March 2023 to the date of this report was David Morgan.

Directors' indemnities

The Articles provide, subject to the provisions of UK legislation, an indemnity for Directors and Officers of the Company in respect of liabilities they may incur in the discharge of their duties or in the exercise of their powers, including any liabilities relating to the defence of any proceedings brought against them, which relate to anything done or omitted, or alleged to have been done or omitted, by them as Officers or employees of the Company. Directors' and Officers' liability insurance cover is in place in respect of all Directors of the Group.

Corporate Governance

The role and structure of the Board

The Board of Directors (the Board) is responsible for the long-term success of the Company and provides leadership. The Board focuses on setting strategy and monitoring performance and ensures that the necessary financial and human resources are in place to enable the Company to meet its objectives.

The Board is responsible for setting the tone from the top in relation to conduct, culture and values, for ensuring continuing commitment to treating customers fairly, carrying out business honestly and openly and preventing bribery, corruption, fraud or the facilitation of tax evasion.

The Board operates in accordance with the Company's Articles of Association (the Articles) and its own written terms of reference. The Board has established an Audit and a Risk Committee, which each have their own terms of reference and are reviewed at least annually. Details of each Committee's activities during 2022 are shown below.

The Board retains specific powers in relation to the approval of the Company's strategic aims, policies and other matters, which must be approved by it under legislation or the Articles. These powers are set out in the Board's written terms of reference and Matters Reserved to the Board which are reviewed at least annually.

The Board met 14 times during 2022. There were four standalone CCFSL Board meetings and 10 joint meetings held with the OSB and OSBG Boards.

Roles of the Chairman, Chief Executive Officer and Senior Independent Director

The roles of Chairman and Chief Executive Officer (CEO) are distinct and held by different people. There is a clear division of responsibilities, which has been agreed by the Board and is formalised in a schedule of responsibilities for each.

The Chairman of the Company, Rod Duke, is responsible for setting the 'tone at the top' and ensuring that the Board has the right mix of skills, experience and development so that it can focus on the key issues affecting the business and for leading the Board and ensuring it acts effectively. Andy Golding, as CEO of the Group and Director of the Company, has overall responsibility for managing the Group and the Company and implementing the strategies and policies agreed by the Board.

Noël Harwerth is the Senior Independent Director (SID) of the Company and Group. The SID's role is to act as a sounding board for the Chairman and to support him in the delivery of his objectives. This includes ensuring that the views of all other Directors are communicated to, and given due consideration by, the Chairman.

Balance and independence

The effectiveness of the Board and its Committees in discharging their duties is essential for the success of the Company. In order to operate effectively, the Board and its Committees comprise a balance of skills, experience, independence and knowledge to encourage constructive debate and challenge to the decision-making process.

Audit Committee

The primary role of the Committee is to support the Board in overseeing the systems of internal control and external financial reporting. The Committee's specific responsibilities are set out in its terms of reference, which are reviewed at least annually. The Audit Committee is chaired by Rajan Kapoor, the other members are Graham Allatt, Noël Harwerth and Simon Walker. The Committee met jointly with the Group Audit Committee seven times during 2022. The Committee considered, on behalf of the Board, whether the 2022 Annual Report and audited financial statements taken as a whole are fair, balanced and understandable and, whether the disclosures are appropriate. Further details on the activities of the Committee are set out in the OSBG annual report and accounts.

Risk Committee

The primary objective of the Committee is to support the Board in discharging its risk oversight and governance responsibilities. The Committee's specific responsibilities are set out in its terms of reference, which are reviewed at least annually. The Committee was chaired by Graham Allatt (throughout 2021 and until 4 January 2022) and is now chaired by Simon Walker (from 4 January 2022). The other members are Graham Allatt, Noël Harwerth and Rajan Kapoor. The Committee met jointly with the Group Risk Committee seven times during 2022. All members attended these meetings. Further details on the activities of the Committee are set out in the OSBG annual report and accounts.

Environment

Environmental matters are considered in the Strategic report above.

Internal control

The Board retains ultimate responsibility for setting the Company's risk appetite and ensuring that there is an effective Risk Management Framework to maintain levels of risk within the risk appetite. The Board regularly reviews its procedures for identifying, evaluating and managing risk, acknowledging that a sound system of internal control should be designed to manage rather than eliminate the risk of failure to achieve business objectives.

Capital structure

No Ordinary shares were issued during 2022 (2021: no Ordinary shares were issued).

Details of issued share capital of the Company are set out in note 32 to the financial statements. The Company has one class of ordinary shares which carries no right to fixed income. The rights and obligations attaching to ordinary shares are set out in the Articles of Association of the Company.

Events after the reporting date

The Directors have proposed an interim dividend of £44.9m in relation to profits for the year ended 31 December 2022 and a special dividend of £20.0m as its contribution to the proposed OSBG dividends. There is no final dividend proposed.

Auditor

Deloitte were appointed by the Board of Directors on 6 July 2009 to audit the financial statements for the year ending 31 December 2009 and subsequent financial periods. The period of Deloitte's total uninterrupted engagement including previous renewals and reappointments is 14 years, covering the years ending 31 December 2009 to 31 December 2022. The Company was granted a banking licence in 2015 and as a public interest entity (PIE) Deloitte has a maximum tenure of 10 years from 2015 which can be extended to 20 years by way of mandatory tender. Since the Company became a PIE, Deloitte's period of uninterrupted engagement is 8 years, covering the years ending 31 December 2015 to 31 December 2022.

Deloitte LLP was appointed as auditor for the year and has indicated its willingness to continue in office as auditor.

Approved by the Board of Directors and signed on its behalf by:

[redacted]

David Morgan
Company Secretary
04 April 2023

2 Charter Court,
Broadlands,
Wolverhampton,
West Midlands,
WV10 6TD

Statement of Directors’ Responsibilities in respect of the Strategic Report, the Directors' Report and the Financial Statements

For the Year Ended 31 December 2022

The Directors are responsible for preparing the annual 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 are required to prepare the financial statements in accordance with UK-adopted International Financial Reporting Standards (IFRS) and applicable law.

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 their profit or loss for the year. In preparing the Company financial statements, the Directors are required to:

– select suitable accounting policies and then apply them consistently;

– make judgements and estimates that are reasonable, relevant and reliable;

– state whether they have been prepared in accordance with IFRSs as adopted by the UK;

– assess the Group and parent Company’s ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and

– use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

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

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors’ Report and for making disclosures on Directors’ remuneration and corporate governance that complies with that law and those regulations.

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

Responsibility statement of the Directors in respect of the annual financial report

Each of the persons who is a Director at the date of approval of this report confirms, to the best of their knowledge, that:

– the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and

– the Strategic Report/Directors’ Report includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties that they face.

Each of the persons who is a Director at the date of approval of this report confirms that:

– so far as the Director is aware, there is no relevant audit information of which the Company’s auditor is unaware; and

– they have taken all the steps they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company’s auditors are aware of that information.

Charter Court Financial Services Limited
Statement of Directors' Responsibilities in respect of the Strategic Report, the Directors' Report and the Financial Statements

For the Year Ended 31 December 2022

Approved by the Board of Directors and signed on its behalf by:

[redacted]

David Morgan
Company Secretary
04 April 2023

2 Charter Court,
Broadlands,
Wolverhampton,
West Midlands,
WV10 6TD

Independent Auditor's Report to the Members of Charter Court Financial Services Limited

Independent auditor's report to the members of Charter Court Financial Services Limited

Report on the audit of the financial statements

1. Opinion

In our opinion the financial statements of Charter Court Financial Services Limited (the 'Company'):

- give a true and fair view of the state of the Company's affairs as at 31 December 2022 and of its profit for the year then ended ;
- have been properly prepared in accordance with United Kingdom adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the statement of comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows; and
- the related notes 1 to 41 of the financial statements.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom adopted international accounting standards.

2. 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 Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the Group and parent company for the year are disclosed in note 8 to the financial statements.

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

Independent Auditor's Report to the Members of Charter Court Financial Services Limited

3. Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • loan impairment provisions; • effective interest rate income recognition; and • the valuation of assets held at fair value through other comprehensive income. Within this report, key audit matters are identified as follows: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used in the current year was £8.9m (2021: £7.8m) which was determined by reference to profit before tax and net assets.
Scoping	Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.
Significant changes in our approach	In the current year, the Company has assessed how increases in inflation and interest rates may impact customers, and has recognised separate cost of living and cost of borrowing post model adjustments (PMAs) in estimating provisions for expected credit losses on loans to address these emerging risks. The calculation of these PMAs is inherently judgmental because there is limited recent data available to estimate how increases in inflation and interest rates may impact customers. We have considered these PMAs in our loan impairment provisions key audit matter.

4. 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:

- We obtained and read management's going concern assessment, which included consideration of the Company's operational resilience, in order to understand, challenge and evidence the key judgements made by management;
- We obtained an understanding of relevant controls around management's going concern assessment;
- We obtained management's income statement, balance sheet and capital and liquidity forecasts and assessed key assumptions, including climate risk considerations, for reasonableness and their projected impact on capital and liquidity ratios, particularly with respect to loan book growth and potential credit losses;

- Supported by our in-house prudential risk specialists, we read the most recent ICAAP and ILAAP submissions, assessed management's capital and liquidity projections, assessed the results of management's capital reverse stress testing, evaluated key assumptions and methods used in the capital reverse stress testing model and tested the mechanical accuracy of the capital reverse stress testing model;
- We read correspondence with regulators to understand the capital and liquidity requirements imposed by the Company's regulators, and evidence any changes to those requirements;
- We met with the Company's lead regulator, the Prudential Regulation Authority, and discussed their views on existing and emerging risks to the Company and considered whether these were reflected appropriately in management's forecasts and stress tests;
- We assessed the historical accuracy of forecasts prepared by management;
- We assessed the impact of the ongoing economic uncertainty, including how further rises in living and borrowing costs may impact potential credit losses; and
- We evaluated the Company's disclosures on going concern against the requirements of IFRS and in view of the FRC guidance.

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 at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

5. 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 forming our opinion thereon, and we do not provide a separate opinion on these matters.

5.1. Loan impairment provisions

Refer to the judgements in applying accounting policies and critical accounting estimates on page 65 and Note 2.

Key audit matter description	IFRS 9 requires loan impairment provisions to be recognised on an expected credit loss (ECL) basis. The estimation of ECL provisions in the Company's loan portfolios is inherently uncertain and requires significant judgements and estimates. We therefore consider this to be a key audit matter due to the risk of fraud or error in respect of the Company's ECL provision. ECL provisions as at 31 December 2022 were £26.3m (2021: £17.9m), which represented 0.28% (2021: 0.22%) of loans and advances to customers. ECLs are calculated both for individually significant loans

and collectively on a portfolio basis which require the use of statistical models incorporating loss data and assumptions on the recoverability of customers' outstanding balances.

As set out on page 9, the Company has implemented various model and staging enhancements during the year as well as updating the IFRS 9 models as part of the Internal Ratings Based (IRB) programme.

The uncertain economic environment continues to increase the complexity in estimating ECLs, particularly with regards to determining appropriate forward looking macroeconomic scenarios and identifying customers who have experienced significant increases in credit risk. Additionally, rising living and borrowing costs observed over the past year have increased the degree of subjectivity in estimating an appropriate probability of default (PD) for customers.

We identified four specific areas in relation to ECL that require significant judgement or relate to assumptions to which the overall ECL provision is particularly sensitive.

- Significant increase in credit risk (SICR): The assessment of whether there has been a significant increase in credit risk between the date of origination of the exposure and 31 December 2022. There is a risk that the Company's staging criteria does not capture SICR or are applied incorrectly.
- Macroeconomic scenarios: As set out on page 60, the Company sources economic forecasts from a third-party economics expert and then applies judgement to determine which scenarios to select and the probability weightings to assign. The Company considered four probability weighted scenarios, including base, upside, downside and severe downside scenarios. The key economic variables used within the macroeconomics model were determined to be the house price index (HPI) and unemployment. The estimation of these variables involves a high degree of subjectivity and estimation uncertainty.
- Post model adjustments (PMAs): The Company has assessed how increases in inflation and interest rates may impact customers, and has recognised separate cost of living and cost of borrowing PMAs to reflect these emerging risks. The calculation of these PMAs is inherently judgemental because there is limited recent data available to estimate how increases in inflation and interest rates may impact customers.
- Propensity to go into possession following default (PPD) and forced sale discount (FSD) assumptions: PPD measures the likelihood that a defaulted loan will progress into repossession. FSD measures the difference in sale proceeds between a sale under normal conditions and sale at auction. The loss given default (LGD) by loan assumed in the ECL provision calculation is highly sensitive to the PPD and FSD assumptions.

How the scope of our audit responded to the key audit matter	We obtained an understanding of the relevant financial controls over the ECL provision with particular focus on controls over significant assumptions and judgements used in the ECL determination. To challenge the Company’s SICR criteria, we: • Evaluated the Company’s SICR policy and assessed whether it complies with IFRS 9; • Assessed the quantitative and qualitative thresholds used in the SICR assessment by reference to standard validation metrics including the proportion of transfers to stage two driven solely by being 30 days past due, the volatility of loans in stage two and the proportion of loans that spend little or no time in stage two before moving to stage three; • Tested the completeness and accuracy of the data used in applying the quantitative and qualitative criteria in the SICR assessment to assess whether loans were assigned to the correct stage; • Supported by our credit risk specialists, peformed a full review of the computer codes used to perform the SICR assessment; • As part of our testing of the application of the SICR criteria within the ECL model and with support from our credit risk specialists, we independently reperformed the Company’s staging assessment across all three stages using our in-house analytics tool; and • Performed an independent assessment for a sample of loan accounts which exhibited forbearance, to determine whether they had been appropriately allocated to the correct stage. To challenge the Company’s macroeconomic scenarios and the probability weightings applied we: • Agreed the macroeconomics scenarios used in the ECL model to reports prepared by the third-party economics expert; • Assessed the competence, capability and objectivity of the third-party economics expert, which included making specific inquiries to understand their approach and modelling assumptions to derive the scenarios; • Supported by our economic specialists, assessed and challenged the scenarios considered and the probability weightings assigned to them in light of the economic environment as at 31 December 2022; • With the involvement of our economic specialists challenged the Company’s economic outlook by reference to other available economic outlook data; • Supported by our credit risk specialists, assessed the model methodology and performed a full review of the computer code used in the macroeconomics model which applies the scenarios to the relevant ECL components; • Compared the appropriateness of selected macroeconomic variables (HPI and unemployment) and the four probability weightings used in the macroeconomics model to those used by peer lenders; • Supported by our credit risk specialists, assessed the performance of the macroeconomic model to confirm whether the economic variables previously

	selected were still appropriate through considering the modelled macroeconomic results relative to those observed in historical recessions; and • For a sample of loans, we independently recalculated the ECL using the macroeconomic variables to check they were being applied appropriately. To challenge the Company's cost of living and cost of borrowing PMAs we: • Supported by our credit risk specialists, assessed whether the risks were already captured within the existing macroeconomics models; • Evaluated the methodology, including key assumptions and reviewed the computer codes used to determine the PMAs; and • Tested the completeness, accuracy and relevance of the data used. To challenge the Company's PPD and FSD assumptions we: • Supported by our credit risk specialists, performed a full review of the computer codes in the LGD models; • Recalculated the PPD rates observed on defaulted loans and compared them to the rates used by the Company in the ECL models; • Recalculated the FSD observed on recent property sales on defaulted loans and compared them to the rates used by the Company in the ECL models; • Considered the findings raised in the Company's model monitoring and validation exercise and assessed the impact on the year-end provision; and • Performed a stand back test to consider potential contradictory evidence and assessed the appropriateness of PPD and FSD assumptions by comparison to industry peers.
Key observations	We determined that the methodology, and the SICR criteria and PPD and FSD assumptions, used in determining the ECL provision as at 31 December 2022 are reasonable. We observed that the macroeconomic scenarios selected by the directors and the probability weightings applied generate an appropriate portfolio loss distribution, and we determined the Company's cost of living and cost of borrowing PMAs are reasonable. We therefore determined that loan impairment provisions are appropriately stated.

5.2. Effective interest rate income recognition

Refer to the judgements in applying accounting policies and critical accounting estimates on page 66, the accounting policy on pages 52 and Notes 4 and 5 on page 69 and 70.

Key audit matter description	In accordance with the requirements of IFRS 9, directly attributable fees, discounts, incentives and commissions on an effective interest rate basis (EIR) are required to be spread over the expected life of the loan assets. EIR is complex and the Company's approach to determining the EIR involves the use of models and

	significant estimation in determining the behavioural life of loan assets. Given the complexity and judgement involved in accounting for EIR and given that revenue recognition is an area susceptible to fraud, there is an opportunity for management to manipulate the amount of interest income reported in the financial statements. The Company's net interest income for the year ended 31 December 2022 was £303.5m (2021: £230.0m). EIR adjustments arise from revisions to estimated cash receipts or payments for loan assets that occur for reasons other than a movement in market interest rates or credit losses. They result in an adjustment to the carrying amount of the loan asset, with the adjustment recognised in the income statement in interest receivable and similar income. As the EIR adjustments reflect changes to the timing and volume of forecast customer redemptions, they are inherently judgemental. The level of judgement exercised is increased where there is limited availability of historical repayment information. The EIR adjustments are sensitive to changes in the behavioural life curves. As set out on page 66, changes in the modelled behavioural life of these portfolios during the year resulted in an interest income charge of £41.6m (2021: £14.7m). The EIR adjustments have increased as a result of the rising interest rate environment. The current economic environment brings additional uncertainty with regards to forecasting expected behavioural lives and prepayment rates. We therefore considered there to be an increased level of risk in respect of this key audit matter in the current year.
How the scope of our audit responded to the key audit matter	We obtained an understanding of the relevant controls over EIR, focusing on the calculation and review of EIR adjustments and the determination of prepayment curves. With the involvement of our in-house analytics and modelling specialists we ran the Company's loan data for the long-term lending products through our own independent EIR model, using the behavioural life curves derived by the Company. We compared our calculation of the EIR adjustment required to the amount recorded by management. A number of assumptions are made to adjust actual behavioural data over recent years to reflect the Company's best estimate of expected future behaviour. For material assumptions, we independently challenged the reasonableness of the assumptions considering the context of the rising rate environment that has been experienced over the last year. With the involvement of our in-house analytics and modelling specialists we independently derived a behavioural life curve using the Company's actual loan data over recent years and incorporating those assumptions that we considered reasonable. We used these curves in our own independent EIR model to calculate the EIR adjustments. We compared this output to the amounts recorded by the Company.

	We also tested the completeness and accuracy of a sample of inputs into the EIR model for originated loans.
Key observations	We determined that the EIR models and assumptions used were appropriate and that net interest income for the period is appropriately stated.

5.3. The valuation of assets held at fair value through other comprehensive income

Refer to the key sources of estimation uncertainty on page 66, the accounting policy on page 55 and Note 16 on page 76.

Key audit matter description	In accordance with the requirements of IFRS 9, management has previously determined that the Company operates two business models. In addition to the 'held to collect' business model where loans and advances to customers are held at amortised cost, the Company had a secondary business model which was 'held to collect and sell'. Management has determined that the Company now operates under one 'held to collect' business model, with the 'held to collect and sell' business model ceasing to operate from February 2022 due to the intention to securitise assets direct from the Company's balance sheet going forward, rather than selling them to a fellow subsidiary. The Company's loans and advances to customers that were originated under the 'held to collect and sell' business model prior to the move to a single business model continue to be held at fair value through other comprehensive income ('FVOCI'). At 31 December 2022, the Company held £795.0m (2021: £945.6m) of loans and advances to customers at fair value. The valuation of these assets is material and is highly sensitive to changes in key assumptions, including the discount rate and prepayment rates. Given the complexity and judgement involved in determining the fair value, we identified a key audit matter due to the risk of fraud or error in respect of the valuation of this portfolio of loans and advances to customers.
How the scope of our audit responded to the key audit matter	We obtained an understanding of the relevant controls relating to the FVOCI model with particular focus on controls over significant management assumptions and judgements. To challenge the valuation of the FVOCI loans and advances to customers, with the involvement of our in-house valuation specialists, we derived an independent fair value using external inputs. We compared our fair value adjustment to that derived by management. We tested the completeness and accuracy of a sample of inputs into the FVOCI model.

	For the key assumptions to which the fair value was most sensitive, such as the discount rate and prepayment rates, where relevant, we also examined the consistency of those assumptions with other models used within the Company.
Key observations	We determined management's valuation of assets held at FVOCI to be within an acceptable range of our independent valuation. We determined that management's valuation is appropriately stated.

6. Our application of materiality

6.1. Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£8.9m (2021: £7.8m)
Basis for determining materiality	We determined materiality for the Company by reference to 1% of net assets of £894.1m (£8.9m), which equates to c.3% of statutory profit before tax of £263.3m. The basis of materiality is consistent with prior year.
Rationale for the benchmark applied	Consistent with the prior year, we considered both net assets and a profit-based measure as benchmarks for determining materiality. We determined 1% of net assets to be the most relevant and stable benchmark to determine materiality.

6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Performance materiality was set at 70% of materiality for the 2022 audit (2021: 70%). In determining performance materiality, we considered the following factors:

- our understanding and the quality of the control environment;
- our understanding of the business; and
- the low number of corrected and uncorrected misstatements identified in the prior year.

6.3. Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £445k (2021: £390k), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

7.1. Scoping

Our audit was scoped by obtaining an understanding of the entity and its environment, including internal control, and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

7.2. Our consideration of the control environment

We identified the key IT systems relevant to the audit to be those used in financial reporting, lending and savings areas. For these controls, with the involvement of our IT specialists, we performed testing over the general IT controls, including testing of user access and change management systems.

Where deficiencies were identified in the control environment, including deficiencies in IT controls, our risk assessment procedures included an assessment of those deficiencies to determine the impact on our audit plan. Where we were unable to identify or test mitigating controls, we adopted a non-controls reliance approach and performed additional substantive procedures. As a result of deficiencies identified in internal IT access controls within the Company, we amended our planned audit procedures to adopt a non-controls reliance approach over lending and related interest income, and over deposit balances and related interest expense.

7.3. Our consideration of climate-related risks

In planning our audit, we have considered the impact of climate change on the Company's operations and impact on its financial statements. The Company, as part of OSB GROUP PLC, has set out its commitments, aligned with the goals of the Paris Climate Accord, to be a net zero bank by 2050. The Company sets out its assessment of the potential impact of climate change on page 5 of the Strategic Report of the Annual Report and the potential impact on the financial statements in note 2 on page 65.

In conjunction with our climate risk specialists, we have held discussions with the Company to understand:

- the process for identifying affected operations, including the governance and controls over this process, and the subsequent effect on the financial reporting for the Company; and
- the long-term strategy to respond to climate change risks as they evolve.

Our audit work has involved:

- challenging the completeness of the physical and transition risks identified and considered in the Company's climate risk assessment and the conclusion that there is no material impact of climate change risk on current year financial reporting;
- with the involvement of our credit risk specialists, assessing management's approach to the incorporation and quantification of climate change risks within a PMA in the ECL provision, which included:

  - assessing management's selected climate pathway used in order to quantify the potential impact of physical risks on the Company's loan book and in particular how the underlying property may be impacted as a result;
  - assessing how different lending segments may be impacted by transition risks and in particular how the buy-to-let portfolio may be impacted by more stringent EPC criteria; and
  - assessing the relevance of the data used in the assessment.
- assessing the appropriateness of disclosures included in the financial statements and challenging the consistency between the financial statements and the remainder of the Annual Report.

8. 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 our 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 this other information, we are required to report that fact.

We have nothing to report in this regard.

9. Responsibilities of Directors

As explained more fully in the Directors' responsibilities statement, 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.

10. 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.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

11. Extent to which 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 material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1. Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the Company's remuneration policies, key drivers for Directors' remuneration, bonus levels and performance targets;
- the Company's own assessment of the risks that irregularities may occur either as a result of fraud or error that was approved by the Board;
- results of our enquiries of management, internal audit and the Audit Committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the Company's documentation of their policies and procedures relating to:
    - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
    - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud; and
    - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and relevant internal specialists, including tax, valuations, IT, climate risk, prudential risk, economics, credit risk and analytics and modelling specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: loan impairment provisions, effective interest rate income recognition and the valuation of assets held at fair value through other comprehensive income. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory framework that the Company operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act and tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the Company’s ability to operate or to avoid a material penalty. These included the Company’s prudential regulatory requirements and capital, liquidity and conduct requirements.

11.2. Audit response to risks identified

As a result of performing the above, we identified loan impairment provisions, effective interest rate income recognition and the valuation of assets held at fair value through other comprehensive income as key audit matters related to the potential risk of fraud. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to those key audit matters.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the Audit Committee and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the Prudential Regulation Authority, the Financial Conduct Authority and HMRC; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Independent Auditor’s Report to the Members of Charter Court Financial Services Limited

Report on other legal and regulatory requirements

12. 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 the Directors’ Report have been prepared in accordance with applicable legal requirements.

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 any material misstatements in the Strategic Report or the Directors’ Report.

13. Matters on which we are required to report by exception

13.1. Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- 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 are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

13.2. Directors’ remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of Directors’ remuneration have not been made.

We have nothing to report in respect of this matter.

14. Other matters which we are required to address

14.1. Auditor tenure

Following the recommendation of the Audit Committee, we were appointed by the Board of Directors on 6 July 2009 to audit the financial statements for the year ending 31 December 2009 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 14 years, covering the years ending 31 December 2009 to 31 December 2022.

14.2. Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

Independent Auditor's Report to the Members of Charter Court Financial Services Limited

15. 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.

Sarah Law, ACA (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

04 April 2023

Charter Court Financial Services Limited
Statement of Comprehensive Income

For the Year Ended 31 December 2022

	Note	**2022** **£m**	2021 £m
Interest receivable and similar income	3	**465.3**	300.8
Interest payable and similar charges	4	**(161.8)**	(70.8)
Net interest income		**303.5**	230.0
Fair value gains on financial instruments	5	**42.2**	11.9
Gain on sale of financial instruments	6	**-**	2.4
Other operating income	7	**2.2**	1.6
Total income		**347.9**	245.9
Administrative expenses	8	**(75.2)**	(65.7)
Provisions		**-**	0.1
Impairment of financial assets	18	**(8.6)**	8.1
Integration costs	9	**(0.8)**	(1.0)
Profit before taxation		**263.3**	187.4
Taxation	11	**(69.1)**	(49.5)
Profit for the year		**194.2**	137.9
Other comprehensive (expense)/income			
Items which may be reclassified to profit or loss:			
Fair value changes on financial instruments measured at FVOCI:			
Arising in the year		**(11.4)**	16.9
Tax on items in other comprehensive (expense)/income		**9.5**	(0.8)
Other comprehensive (expense)/income		**(1.9)**	16.1
Total comprehensive income for the year		**192.3**	154.0

The above results are derived wholly from continuing operations.

The notes on pages 51 to 118 form part of these financial statements.

The financial statements were approved by the Board of Directors on 04 April 2023.

Charter Court Financial Services Limited
Statement of Financial Position
As at 31 December 2022

	Note	2022 £m	2021 £m
Assets			
Loans and advances to credit institutions	14	**1,632.0**	1,269.1
Investment securities	15	**202.3**	477.8
Loans and advances to customers	16	**10,260.9**	8,789.3
Fair value adjustments on hedged assets	20	**(375.5)**	(68.4)
Derivative assets	19	**447.2**	86.9
Other assets	21	**3.8**	4.5
Current taxation asset		**0.1**	0.4
Deferred taxation asset	30	**5.2**	-
Property, plant and equipment	22	**7.1**	8.1
Intangible assets	23	**2.9**	4.2
Total assets		**12,186.0**	10,571.9
Liabilities			
Amounts owed to credit institutions	24	**2,524.3**	1,900.8
Amounts owed to retail depositors	25	**8,623.1**	7,785.4
Fair value adjustments on hedged liabilities	20	**(20.7)**	(8.6)
Amounts owed to other customers	26	**112.6**	86.8
Derivative liabilities	19	**42.8**	11.3
Lease liabilities	27	**5.2**	5.6
Other liabilities	28	**4.6**	5.5
Provisions	29	**-**	0.1
Deferred taxation liability	30	**-**	4.4
		11,291.9	9,791.3
Equity			
Share capital	32	**2.9**	2.9
Share premium	32	**67.3**	67.3
Retained earnings		**747.3**	631.9
Other reserves	33	**76.6**	78.5
		894.1	780.6
Total equity and liabilities		**12,186.0**	10,571.9

The notes on pages 51 to 118 form part of these financial statements.

The financial statements were approved by the Board of Directors and authorised for issue on 04 April 2023 and signed on its behalf by:

[redacted]

April Talintyre
Director

Charter Court Financial Services Limited
Statement of Changes in Equity
For the Year Ended 31 December 2022

	Share capital £m	Share premium £m	FVOCI reserve £m	Additional Tier 1 (AT1) securities £m	Retained earnings £m	Total £m
At 1 January 2021	2.9	67.3	2.4	-	494.0	566.6
Profit for the year	-	-	-	-	137.9	137.9
Other comprehensive income	-	-	16.9	-	-	16.9
Tax recognised in equity	-	-	(0.8)	-	-	(0.8)
Total comprehensive income	-	-	16.1	-	137.9	154.0
Issuance of AT1 securities	-	-	-	60.0	-	60.0
At 31 December 2021	2.9	67.3	18.5	60.0	631.9	780.6
Profit for the year	**-**	**-**	**-**	**-**	**194.2**	**194.2**
Other comprehensive expense	**-**	**-**	**(11.4)**	**-**	**-**	**(11.4)**
Tax recognised in equity	**-**	**-**	**9.5**	**-**	**-**	**9.5**
Total comprehensive (expense)/income	**-**	**-**	**(1.9)**	**-**	**194.2**	**192.3**
Coupon paid on AT1 securities	**-**	**-**	**-**	**-**	**(3.6)**	**(3.6)**
Dividends paid (see note 12)	**-**	**-**	**-**	**-**	**(75.2)**	**(75.2)**
At 31 December 2022	**2.9**	**67.3**	**16.6**	**60.0**	**747.3**	**894.1**

The movement in other comprehensive income (OCI) during 2022 includes fair value movements of residential mortgages held at fair value through other comprehensive income (FVOCI) stated after a loss allowance for the year of £0.2m charge (2021: £(0.5)m credit) and effective interest rate (EIR) adjustments for the year of £3.0m (2021: £(3.1)m).

Share capital and premium is disclosed in note 32 and the reserves are further analysed in note 33.

Charter Court Financial Services Limited
Statement of Cash Flows

For the Year Ended 31 December 2022

	Note	2022 £m	2021 £m (Restated)[1]
Cash flows from operating activities			
Profit before taxation		**263.3**	187.4
Adjustments for non-cash items[1]	38	**(1.1)**	(17.8)
Changes in operating assets and liabilities[1]	38	**(388.0)**	(36.7)
Cash (used)/generated in operating activities		**(125.8)**	132.9
Net tax paid		**(69.3)**	(47.1)
Net cash (used)/generated in operating activities[1]		**(195.1)**	85.8
Cash flows from investing activities			
Maturity and sales of investment securities	15	**215.3**	535.8
Purchases of investment securities	15	**(40.2)**	(452.5)
Interest received on investment securities		**5.1**	-
Purchases of property, plant and equipment and intangible assets	22,23	**(0.6)**	(1.8)
Cash generated from investing activities		**179.6**	81.5
Cash flows from financing activities			
Financing received[1]	31	**309.5**	1,826.2
Financing repaid	31	**(2.5)**	(1,667.9)
Interest paid on financing	31	**(15.4)**	(1.8)
Coupon paid on AT1 securities		**(3.6)**	-
Dividends paid		**(75.2)**	-
Issuance of AT1 securities		**-**	60.0
Cash payments on lease liabilities	27	**(1.0)**	(1.0)
Cash generated from financing activities		**211.8**	215.5
Net increase in cash and cash equivalents		**196.3**	382.8
Cash and cash equivalents at the beginning of the year	13	**1,282.9**	900.1
Cash and cash equivalents at the end of the year	13	**1,479.2**	1,282.9
Movement in cash and cash equivalents		**196.3**	382.8

1. 2021 figures restated see note 1 b) for further details.

1. Accounting policies

a) Company information

Charter Court Financial Services Limited is a private company limited by shares registered in England and Wales. The address of the Company's registered office is shown on page 1.

The principal accounting policies applied in the preparation of the financial statements are set out below.

b) Restatement

In the prior year, cash collateral and margin received on interest rate swaps of £73.3m was included in financing cash flows in the Statement of Cash Flows. As the cash flows arise on hedging activities related to items classified as operating assets and liabilities within the Statement of Cash Flows, the cash flows should be included within operating cash flows. In the current year, cash collateral and margin received on interest rate swaps has been classified as an operating cash flow and the 2021 Statement of Cash Flows restated to reclassify a cash inflow of £73.3m from financing activities to operating activities.

The Company has voluntarily restated the prior year comparatives for a classification change within operating activities to be consistent with the parent company consolidated accounts. Previously, the movement on fair value adjustments on hedged assets/liabilities (FVAHR) of £131.6m were disclosed within Adjustments for non-cash items and the movement on derivative assets/liabilities of £(126.0)m disclosed within Changes in operating assets and liabilities. This created a gross up of non-cash movements between the two lines. In the current year, Adjustments for non-cash items includes Fair value gains on financial instruments of £42.2m and Changes in operating assets and liabilities includes the net movement of FVAHR of £295.0m and derivative assets/liabilities of £(328.8)m. The prior year comparatives have been restated accordingly, with the Movement in fair value of loans and advances to customers held at FVTPL of £1.4m previously disclosed as a line item now included within Fair value gains on financial instruments.

c) Basis of preparation

The financial statements for the Company have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the United Kingdom (UK), interpretations issued by the IFRS Interpretations Committee (IFRS IC) and in conformity with the requirements of the Companies Act 2006. The IFRS's applied for all periods herein presented, are those that are effective for accounting periods beginning on or after 1 January 2022.

The Company's financial statements have been prepared on a historical cost basis, as modified by the revaluation of investment securities held at fair value through other comprehensive income (FVOCI) and derivative contracts and other financial assets held at fair value through profit or loss (FVTPL) (see note 1 m) vi).

The financial statements are presented in Pounds Sterling. All amounts in the financial statements have been rounded to the nearest £0.1m. The functional currency of the Company is Pounds Sterling, which is the currency of the primary economic environment in which the Company operates.

d) Going concern

The Board undertakes regular rigorous assessments of whether the Company is a going concern in light of current economic conditions and all available information about future risks and uncertainties.

In assessing whether the going concern basis is appropriate, projections for the Company and the wider Group have been prepared, covering its future performance, capital and liquidity for a period in excess of 12 months from the date of approval of these financial statements. These forecasts have been subject to sensitivity tests, including stress scenarios, which have been compared to the latest economic scenarios provided by the Group's external economic advisors, as well as reverse stress tests.

1. Accounting policies (continued)

The assessments include the following:

- Financial and capital forecasts were prepared under stress scenarios which were assessed against the latest economic forecasts provided by the Group's external economic advisors. Reverse stress tests were also run, to assess what combinations of House Price Index (HPI), unemployment, default rates and consumer price index variables would result in the Company utilising its regulatory capital buffers in full and breaching the Company's minimum prudential requirements along with analysis and insight from the Company's Internal Capital Adequacy Assessment Process (ICAAP). The Directors assessed the likelihood of those reverse stress scenarios occurring within the next 12 months and concluded that the likelihood is remote.
- The latest liquidity and contingent liquidity positions and forecasts were assessed against the Internal Liquidity Adequacy Assessment Process (ILAAP) stress scenarios, with the Company maintaining sufficient liquidity throughout the going concern assessment period.
- The Company continues to assess the resilience of its business operating model and supporting infrastructure in the context of the emerging economic, business and regulatory environment. The key areas of focus continues to be on the provision of the Company's important business services, minimising the impact of any service disruptions on the Company's customers or the wider financial services industry. The Company's response to the COVID-19 pandemic demonstrated the inherent resilience of the Company's critical processes and infrastructure and its agility in responding to changing operational demands. The Company recognises the need to continually invest in the resilience of its services, with specific focus in 2023 on ensuring that the third parties on which it depends have the appropriate levels of resilience and in further automating those processes that are sensitive to increases in volume.

The Company's financial projections demonstrate that the Company has sufficient capital and liquidity to continue to meet its regulatory capital requirements as set out by the Prudential Regulation Authority (PRA).

The Board has therefore concluded that the Company has sufficient resources to continue in operational existence for a period in excess of 12 months from the date of this report and as a result, it is appropriate to prepare these financial statements on a going concern basis.

e) Interest income and expense

Interest income and interest expense for all interest-bearing financial instruments measured at amortised cost and FVOCI are recognised in profit or loss using the effective interest rate (EIR) method. The EIR is the rate which discounts the expected future cash flows, over the expected life of the financial instrument, to the net carrying value of the financial asset or liability.

Interest income on financial assets categorised as stage 1 or 2 are recognised on a gross basis, with interest income on stage 3 assets recognised net of expected credit losses (ECL). For purchased or credit-impaired assets (see note 1 m) vii.), interest income is calculated by applying the credit-adjusted EIR to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis even if the credit risk of the asset improves. See note 1 m) ii.) for further information on IFRS 9 stage classifications.

When calculating the EIR, the Company estimates cash flows considering all contractual terms of the instrument and behavioural aspects (for example, prepayment options) but not considering future credit losses. The calculation of the EIR includes transaction costs and fees paid or received that are an integral part of the interest rate, together with the discounts or premiums arising on the acquisition of loan portfolios. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial instrument.

1. Accounting policies (continued)

The Company monitors the actual cash flows for each book and resets cash flows on a monthly basis, discounted at the EIR to derive a new carrying value, with changes taken to profit or loss as interest income.

The EIR is adjusted where there is a movement in the reference interest rate (Sterling Overnight Index Average (SONIA), synthetic London Interbank Offered Rate (LIBOR) or BoE base rate) affecting portfolios with a variable interest rate which will impact future cash flows. The revised EIR is the rate which exactly discounts the revised cash flows to the net carrying value of the loan portfolio.

When the contractual terms of non-derivative financial instruments have been amended as a direct consequence of Interbank Offered Rate (IBOR) reform during 2021 and the new basis for determining the contractual cash flows is economically equivalent to the previous basis, the Company changes the basis for determining the contractual cash flows prospectively by revising the EIR.

Interest income on investment securities is included in interest receivable and similar income. Interest on derivatives is included in interest receivable and similar income or interest expense and similar charges following the underlying instrument it is hedging.

Coupons paid on AT1 securities are recognised directly in equity in the period in which they are paid.

f) Fees and commissions

Fees and commissions which are an integral part of the EIR of a financial instrument are recognised as an adjustment to the EIR and recorded in interest income. The Company includes early redemption charges within the EIR.

Fees received on mortgage administration services and mortgage origination activities, which are not an integral part of the EIR, are recorded in other operating income and accounted for in accordance with IFRS 15 Revenue from Contracts with Customers, with income recognised when the services are delivered and the benefits are transferred to clients and customers.

Other fees and commissions are recognised on the accruals basis as services are provided or on the performance of a significant act, net of VAT and similar taxes.

g) Integration costs

Integration costs are those items of income or expense that do not relate to the Company’s core operating activities, are not expected to recur and are exceptional in the context of the Company’s performance. These items are disclosed separately within the Statement of Comprehensive Income and the Notes to the Financial Statements.

h) Taxation

Income tax comprises current and deferred tax. It is recognised in profit or loss, OCI or directly in equity, consistent with the recognition of items it relates to. The Company recognises tax on coupons paid on AT1 securities directly in profit or loss.

Current tax is the expected tax charge on the taxable income for the year and any adjustments in respect of previous years.

Deferred tax is the tax expected to be payable or recoverable in respect of temporary differences between the carrying amounts of assets or liabilities for accounting purposes and carrying amounts for tax purposes.

1. Accounting policies (continued)

Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available to utilise the asset. The recognition of deferred tax is mainly dependent on the projections of future taxable profits and future reversals of temporary differences. The current projections of future taxable income indicate that the Company will be able to utilise its deferred tax asset within the foreseeable future.

Deferred tax assets and liabilities are recognised for all taxable temporary differences.

The Company is in a group payment arrangement for corporation tax with the companies of the Group.

The Company is also in the same VAT group as the companies of the Group.

i) Dividends

Dividends are recognised in equity in the period in which they are paid or, if earlier, approved by shareholders.

j) Cash and cash equivalents

For the purposes of the Consolidated Statement of Cash Flows, cash and cash equivalents comprise cash, non-restricted balances with credit institutions and highly liquid financial assets with maturities of less than three months from date of acquisition, subject to an insignificant risk of changes in their fair value and are used by the Company in the management of its short-term commitments.

k) Property, plant and equipment

Property, plant and equipment comprise leasehold property improvements, equipment and fixtures measured at cost less accumulated depreciation. These assets are reviewed for impairment annually, and if they are considered to be impaired, are written down immediately to their recoverable amounts.

Items of property, plant and equipment are depreciated on a straight-line basis over their estimated useful economic lives as follows:

Leasehold improvements	10 years
Equipment and fixtures	5 years

The cost of repairs and renewals is charged to profit or loss in the period in which the expenditure is incurred.

l) Intangible assets

Purchased software and costs directly associated with the development of computer software are capitalised as intangible assets where the software is a unique and identifiable asset controlled by the Company and will generate future economic benefits. Costs to establish technological feasibility or to maintain existing levels of performance are recognised as an expense. The Company only recognises internally generated intangible assets if all of the following conditions are met:

- an asset is being created that can be identified after establishing the technical and commercial feasibility of the resulting product;
- it is probable that the asset created will generate future economic benefits; and
- the development cost of the asset can be measured reliably.

Subsequent expenditure on an internally generated intangible asset, after its purchase or completion, is recognised as an expense in the period in which it is incurred. Where no internally generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

1. Accounting policies (continued)

Software-as-a-service (SaaS), is an arrangement that provides the Company with the right to receive access to the supplier's application software in the future which is treated as a service contract, rather than a software lease or the acquisition of a software intangible asset.

An intangible asset is only recognised if:

- The Company has the contractual right to take possession of the software during the hosting period without significant penalty; and
- it is feasible for the Company to run the software on its own hardware or contract with a party unrelated to the supplier to host the software.

The costs of configuring or customising supplier application software in a SaaS arrangement that is determined to be a service contract is recognised as an expense or prepayment. Where the configuration and customisation services are not distinct from the right to receive access to the software, then the costs are recognised as an expense over the term of the arrangement.

Intangible assets are reviewed for impairment semi-annually, and if they are considered to be impaired, are written down immediately to their recoverable amounts. Impairment losses previously recognised for intangible assets, other than goodwill, are reversed when there has been a change in the estimates used to determine the asset's recoverable amount. An impairment loss reversal is recognised in the Statement of Comprehensive Income and the carrying amount of the asset is increased to its recoverable amount.

Intangible assets are amortised in profit or loss over their estimated useful lives as follows:

Computer software and licences	5 year straight line
Development costs	4 year straight line

For development costs that are under construction, no amortisation will be applied until the asset is available for use and is calculated using a full month when available for use.

The Company reviews the amortisation period on an annual basis. If the expected useful life of assets is different from previous assessments, the amortisation period is changed accordingly.

m) Financial instruments

i. Recognition

The Company initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they are originated or acquired. All other financial instruments are accounted for on the trade date which is when the Company becomes a party to the contractual provisions of the instrument.

For financial instruments classified as amortised cost or FVOCI, the Company initially recognises financial assets and financial liabilities at fair value plus transaction income or costs that are directly attributable to its origination, acquisition or issue. Financial instruments classified as amortised cost are subsequently measured using the EIR method.

Transaction costs relating to the acquisition or issue of a financial instrument at FVTPL are recognised in the profit or loss as incurred.

AT1 securities are designated as equity instruments and recognised at fair value on the date of issuance in equity along with incremental costs directly attributable to the issuance of equity instruments.

1. Accounting policies (continued)

ii. Classification

The Company classifies financial instruments based on the business model and the contractual cash flow characteristics of the financial instruments. Under IFRS 9, the Company classifies financial assets into one of three measurement categories:

- **Amortised cost** – assets in a business model to hold financial assets in order to collect contractual cash flows, where the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.
- **FVOCI** – assets held in a business model which collects contractual cash flows and sells financial assets where the contractual terms of the financial assets give rise on specified dates to cash flows that are SPPI on the principal amount outstanding.
- **FVTPL** – assets not measured at amortised cost or FVOCI. The Company measures derivatives and an acquired mortgage portfolio under this category.

The Company classifies non-derivative financial liabilities as measured at amortised cost.

The Company has no non-derivative financial assets or liabilities classified as held for trading.

The Company reassesses its business models each reporting period.

The Company classifies certain financial instruments as equity where they meet the following conditions:

- the financial instrument includes no contractual obligation to deliver cash or another financial asset on potentially unfavourable conditions;
- the financial instrument is a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
- the financial instrument is a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

Equity financial instruments comprise AT1 securities. Accordingly, the coupons paid on the AT1 securities are recognised directly in retained earnings when paid.

iii. Derecognition

The Company derecognises financial assets when the contractual rights to the cash flows expire or the Company transfers substantially all risks and rewards of ownership of the financial asset.

The Company offers refinancing options to customers which have been assessed within the principles of IFRS 9 and relevant guidance. The assessment concludes the original mortgage asset is derecognised at the refinancing point with a new financial asset recognised.

The forbearance measures offered by the Company are considered a modification event as the contractual cash flows are renegotiated or otherwise modified. The Company considers the renegotiated or modified cash flows are not a substantial modification from the contractual cash flows and does not consider that forbearance measures give rise to a derecognition event.

Financial liabilities are derecognised only when the obligation is discharged, cancelled or has expired.

iv. Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the Statement of Financial Position when, and only when, the Company currently has a legally enforceable right to offset the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

1. Accounting policies (continued)

The Company's derivatives are covered by industry standard master netting agreements. Master netting agreements create a right of set-off that becomes enforceable only following a specified event of default or in other circumstances not expected to arise in the normal course of business. These arrangements do not qualify for offsetting and as such the Company reports derivatives on a gross basis.

Collateral in respect of derivatives is subject to the standard industry terms of International Swaps and Derivatives Association (ISDA) Credit Support Annex. This means that the cash received or given as collateral can be pledged or used during the term of the transaction but must be returned on maturity of the transaction. The terms also give each counterparty the right to terminate the related transactions upon the counterparty's failure to post collateral. Collateral paid or received does not qualify for offsetting and is recognised in loans and advances to credit institutions and amounts owed to credit institutions, respectively.

v. Amortised cost measurement

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition, less principal payments or receipts, plus or minus the cumulative amortisation using the EIR method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment of assets.

vi. Fair value measurement

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

When available, the Company measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The Company measures its investment securities and Perpetual Subordinated Bonds (PSBs) at fair value using quoted market prices where available.

If there is no quoted price in an active market, then the Company uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

The Company uses SONIA curves to value its derivatives, previously, a combination of LIBOR and SONIA curves. The fair value of the Company's derivative financial instruments incorporates credit valuation adjustments (CVA) and debit valuation adjustments (DVA). The DVA and CVA take into account the respective credit ratings of the Bank and counterparty and whether the derivative is collateralised or not. Derivatives are valued using discounted cash flow models and observable market data and are sensitive to benchmark interest and basis rate curves.

1. Accounting policies (continued)

vii. Identification and measurement of impairment of financial assets

The Company assesses all financial assets for impairment.

Loans and advances to customers

The Company uses the IFRS 9 three-stage ECL approach for measuring impairment. The three impairment stages are as follows:

- **Stage 1** – a 12 month ECL allowance is recognised where there is no significant increase in credit risk (SICR) since initial recognition.
- **Stage 2** – a lifetime ECL allowance is held for assets where a SICR is identified since initial recognition. The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period for the life of the loan.
- **Stage 3** – requires objective evidence that an asset is credit impaired, at which point a lifetime ECL allowance is recognised.

The Company measures impairment through the use of individual and modelled assessments.

Individual assessment

The Company's provisioning process requires individual assessment for high exposure or higher risk loans, where Law of Property Act (LPA) receivers have been appointed, the property is taken into possession or there are other events that suggest a high probability of credit loss. Loans are considered at a connection level, i.e. including all loans connected to the customer.

The Company estimates cash flows from these loans, including expected interest and principal payments, rental or sale proceeds, selling and other costs. The Company obtains up-to-date independent valuations for properties put up for sale.

For all individually assessed loans with a confirmed sale, should the present value of estimated future cash flows discounted at the original EIR be less than the carrying value of the loan, a provision is recognised for the difference with such loans being classified as impaired. However, should the present value of the estimated future cash flows exceed the carrying value, no provision is recognised. For all remaining individually assessed loans, should a full loss be expected, the provision is set to the carrying value, with all other individually assessed loans applying the greater of either the modelled or individual assessment.

1. Accounting policies (continued)

IFRS 9 modelled impairment

Measurement of ECL

The assessment of credit risk and the estimation of ECL are unbiased and probability weighted. The ECL calculation is a product of an individual loan's probability of default (PD), exposure at default (EAD) and loss given default (LGD) discounted at the EIR. The ECL drivers of PD, EAD and LGD are modelled at an account level. The assessment of whether a SICR has occurred is based on quantitative relative PD thresholds and a suite of qualitative triggers.

In accordance with PRA COVID-19 guidance, the Company did not automatically consider the take up of customer payment deferrals during the pandemic to be an indication of a SICR and, in the absence of other indicators such as previous arrears, low credit score or high other indebtedness, the staging of these loans remains unchanged in its ECL calculations.

Significant increase in credit risk (movement to stage 2)

The Company's transfer criteria determine what constitutes a SICR, which results in an exposure being moved from stage 1 to stage 2.

At the point of initial recognition, a loan is assigned a PD estimate. For each monthly reporting date thereafter, an updated PD estimate is computed. The Company's transfer criteria analyses relative changes in PD versus the PD assigned at the point of origination, together with qualitative triggers using both internal indicators, such as forbearance, and external information, such as changes in income and adverse credit information to assess for SICR. In the event that given early warning triggers have not already identified SICR, an account more than 30 days past due is considered to have experienced a SICR.

A borrower will move back into stage 1 only if the SICR definition is no longer triggered.

Definition of default (movement to stage 3)

The Company uses a number of quantitative and qualitative criteria to determine whether an account meets the definition of default and therefore moves to stage 3. The criteria currently include:

- If an account is more than 90 days past due.
- Accounts that have moved into an unlikely to pay position, which includes forbearance, bankruptcy, repossession and interest-only term expiry.

A borrower will move out of stage 3 when its credit risk improves such that it no longer meets the 90 days past due and unlikely to pay criteria and following this has completed an internally-approved probation period. The borrower will move to stage 1 or stage 2 dependent on whether the SICR applies.

1. Accounting policies (continued)

Forward-looking macroeconomic scenarios

The risk of default and ECL assessments take into consideration expectations of economic changes that are deemed to be reasonably possible.

The Company conducts analysis to determine the most significant factors which may influence the likelihood of an exposure defaulting in the future. The macroeconomic factors relate to the HPI, unemployment rate (UR), Consumer Price Index (CPI), Gross domestic product (GDP), and the BoE base rate.

The Company has developed an approach for factoring probability-weighted macroeconomic forecasts into ECL calculations, adjusting PD and LGD estimates. The macroeconomic scenarios feed directly into the ECL calculation, as the adjusted PD, lifetime PD and LGD estimates are used within the individual account ECL allowance calculations.

The Group sources economic forecast information from an appropriately qualified third party when determining scenarios. The Group considers four probability-weighted scenarios, base, upside, downside and severe downside scenarios.

The base case is also utilised within the Company's impairment forecasting process which in turn feeds the wider business planning processes. This ECL models are also used to set the Company's credit risk appetite thresholds and limits.

Period over which ECL is measured

ECL is measured from the initial recognition of the asset which is the date at which the loan is originated or the date a loan is purchased and at each balance sheet date thereafter. The maximum period considered when measuring ECL (either 12 months or lifetime ECL) is the maximum contractual period over which the Company is exposed to the credit risk of the asset. For modelling purposes, the Company considers the contractual maturity of the loan product and then considers the behavioural trends of the asset.

Purchased or originated credit impaired (POCI)

Acquired loans that meet the Company's definition of default (90 days past due or an unlikely to pay position) at acquisition are treated as POCI assets. These assets attract a lifetime ECL allowance over the full term of the loan, even when these loan no longer meet the definition of default post acquisition. The Company does not originate credit-impaired loans.

Other financial assets

Other financial assets comprise cash balances with BoE and other credit institutions and high grade investment securities. The Company deems the likelihood of default across these counterparties as low and does not recognise a provision against the carrying balances.

1. Accounting policies (continued)

n) Loans and advances to customers

Loans and advances to customers are predominantly mortgage loans and advances to customers with fixed or determinable payments that are not quoted in an active market and that the Company does not intend to sell in the near term. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the EIR method, less impairment losses. Where exposures are hedged by derivatives, designated and qualifying as fair value hedges, the fair value adjustment for the hedged risk to the carrying value of the hedged loans and advances is reported in fair value adjustments for hedged assets.

Loans and the related provision are written off when there is a shortfall remaining after the underlying security is sold. Subsequent recoveries of amounts previously written off are taken through profit or loss.

Loans and advances to customers over which the Company transfers its rights to the collateral thereon to the BoE under the Term Funding Scheme for SMEs (TFSME) are not derecognised from the Consolidated Statement of Financial Position, as the Company retains substantially all the risks and rewards of ownership, including all cash flows arising from the loans and advances and exposure to credit risk. The Company classifies TFSME as amortised cost under IFRS 9 Financial Instruments.

Loans and advances to customers include a small acquired mortgage portfolio where the contractual cash flows include payments that are not SPPI and interest and as such are measured at FVTPL.

Loans and advances to customers contain the Group’s asset finance lease lending. Finance leases are initially measured at an amount equal to the net investment in the lease, using the interest rate implicit in the finance lease. Direct costs are included in the initial measurement of the net investment in the lease and reduce the amount of income recognised over the lease term. Finance income is recognised over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment in the lease.

o) Investment securities

Investment securities comprise securities held for liquidity purposes (UK treasury bills, UK Gilts and RMBS). These assets are non-derivatives that are designated on an individual basis as amortised cost or FVOCI.

Assets classified as amortised cost are initially recognised at fair value and subsequently measured at amortised cost using the EIR method, less impairment losses.

Assets held at FVOCI are measured at fair value with movements taken to OCI) and accumulated in the FVOCI reserve within equity, except for impairment losses which are taken to profit or loss. Where the instrument is sold, the gain or loss accumulated in equity is reclassified to profit or loss.

p) Deposits

Deposits comprise deposits from retail customers and credit institutions, including collateralised loan advances from the BoE under the TFS and TFSME. These financial liabilities are initially measured at fair value less direct transaction costs, and subsequently held at amortised cost using the EIR method.

Cash received under the TFS and TFSME is recorded in amounts owed to credit institutions. Interest is accrued over the life of the agreements on an EIR basis.

1. Accounting policies (continued)

q) Sale and repurchase agreements

Financial assets sold subject to repurchase agreements (repo) are retained in the financial statements if they fail derecognition criteria of IFRS 9 described in paragraph l) iii. above. The financial assets that are retained in the financial statements are reflected as loans and advances to customers or investment securities and the counterparty liability is included in amounts owed to credit institutions or other customers. Financial assets purchased under agreements to resell at a predetermined price where the transaction is financing in nature (reverse repo) are accounted for as loans and advances to credit institutions. The difference between the sale and repurchase price is treated as interest and accrued over the life of the agreement using the EIR method.

r) Derivative financial instruments

The Company uses derivative financial instruments (interest rate swaps) to manage its exposure to interest rate risk. In accordance with the Group Market and Liquidity Risk Policy, the Company does not hold or issue derivative financial instruments for proprietary trading.

Derivative financial instruments are recognised at their fair value with changes in their fair value taken to profit or loss. Fair values are calculated by discounting cash flows at the prevailing interest rates. All derivatives are classified as assets when their fair value is positive and as liabilities when their fair value is negative. If a derivative is cancelled, it is derecognised from the Statement of Financial Position.

The Company also uses derivatives to hedge the interest rate risk inherent in irrevocable offers to lend. This exposes the Company to movements in the fair value of derivatives until the loan is drawn. The changes to fair value are recognised in profit or loss in the period.

s) Hedge accounting

The Company has chosen to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements in Chapter 6 of IFRS 9. The Company uses fair value hedge accounting for a portfolio hedge of interest rate risk.

Portfolio hedge accounting allows for hedge effectiveness testing and accounting over an entire portfolio of financial assets or liabilities. To qualify for hedge accounting at inception, hedge relationships are clearly documented and derivatives must be expected to be highly effective in offsetting the hedged risk. In addition, effectiveness must be tested throughout the life of the hedge relationship. This applies to all derivatives including SONIA-linked derivatives entered into to replace LIBOR-linked derivatives, as a result of IBOR reforms during 2021.

The Company applies fair value portfolio hedge accounting to its fixed rate portfolio of mortgages and saving accounts. The hedged portfolio is analysed into repricing time periods based on expected repricing dates, utilising the ALCO approved prepayment curve. Interest rate swaps are designated against the repricing time periods to establish the hedge relationship. Hedge effectiveness is calculated as a percentage of the fair value movement of the interest rate swap against the fair value movement of the hedged item over the period tested.

1. Accounting policies (continued)

The Company considers the following as key sources of hedge ineffectiveness:

- the mismatch in maturity date of the swap and hedged item, as swaps with a given maturity date cover a portfolio of hedged items which may mature throughout the month;
- the actual behaviour of the hedged item differing from expectations, such as early repayments or withdrawals and arrears;
- minimal movements in the yield curve leading to ineffectiveness where hedge relationships are sensitive to small value changes; and
- the transition relating to LIBOR reforms during 2021 whereby some hedged instruments and hedged items are based on different benchmark rates.

Where there is an effective hedge relationship for fair value hedges, the Company recognises the change in fair value of each hedged item in profit or loss with the cumulative movement in their value being shown separately in the Statement of Financial Position as fair value adjustments on hedged assets and liabilities. The fair value changes of both the derivative and the hedge substantially offset each other to reduce profit volatility.

The Company discontinues hedge accounting when the derivative ceases through expiry, when the derivative is cancelled or the underlying hedged item matures, is sold or is repaid.

If a derivative no longer meets the criteria for hedge accounting or is cancelled whilst still effective, including LIBOR-linked derivatives cancelled as a result of IBOR reforms during 2021, the fair value adjustment relating to the hedged assets or liabilities within the hedge relationship prior to the derivative becoming ineffective or being cancelled remains on the Statement of Financial Position and is amortised over the remaining life of the hedged assets or liabilities. The rate of amortisation over the remaining life is in line with expected income or cost generated from the hedged assets or liabilities. Each reporting period, the expectation is compared to actual with an accelerated run-off applied where the two diverge by more than set parameters.

t) Debit and credit valuation adjustments

The DVA and CVA are included in the fair value of derivative financial instruments. The DVA is based on the expected loss a counterparty faces due to the risk of the Company's default. The CVA reflects the Company's risk of the counterparty's default.

The methodology is based on a standard calculation, taking into account:

- the one-year PD;
- the expected EAD;
- the expected LGD; and
- the average maturity of the swaps.

1. Accounting policies (continued)

u) Provisions

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

Provisions include ECLs on the Company's undrawn loan commitments.

v) Leases

The Company recognises right-of-use assets and lease liabilities for leases over 12 months long. Right-of-use assets and lease liabilities are initially recognised at the net present value of future lease payments, discounted at the rate implicit in the lease or, where not available, the Company's incremental borrowing cost. Subsequent to initial recognition, the right-of-use asset is depreciated on a straight-line basis over the term of the lease. Future rental payments are deducted from the lease liability, with interest charged on the lease liability using the incremental borrowing cost at the time of initial recognition. The Company recognises lease liability payments within financing activities in the Statement of Cash Flows.

The Company assesses the likely impact of early terminations in recognising the right-of-use asset and lease liability where an option to terminate early exists.

For modifications that increase the length of a lease; the modified lease term is determined and the lease liability remeasured by discounting the revised lease payments using a revised discount rate, at the effective date of the lease modification; a corresponding adjustment is made to the right-of-use asset. Where modifications decrease the length of a lease, the lease liability and right-of-use asset are reduced in proportion to the reduction in the lease term, with any gain or loss recognised in the profit or loss.

Leases with low future payments or terms less than 12 months are recognised on an accruals basis directly in profit or loss.

w) Adoption of new standards

International financial reporting standards issued and adopted for the first time in the year ended 31 December 2022

There were a number of minor amendments to financial reporting standards that are effective for the current year. There has been no material impact on the financial statements of the Company from the adoption of these financial reporting standard amendments and interpretations.

International financial reporting standards issued but not yet effective which are applicable to the Company

Certain amendments to accounting standards and interpretations that were not effective on 31 December 2022 have not been early adopted by the Company. The adoption of these amendments are not expected to have a material impact on the financial statements of the Company in future periods.

2. Judgements in applying accounting policies and critical accounting estimates

In preparing these financial statements, the Company has made judgements, estimates and assumptions which affect the reported amounts within the current and future financial years. Actual results may differ from these estimates.

In preparing the financial statements, the Group has considered the impact of climate-related risks on its financial position and performance, including the impact on ECL and redemption profiles included in EIR. While the effects of climate change represent a source of uncertainty, the Group does not consider there to be a material impact on its judgements and estimates from the physical or transition risks in the short term. Accordingly there is no significant risk of material adjustment of the carrying amounts of assets and liabilities within the next financial year as a result of climate change. Whilst not material we have recognised a post model adjustment (PMA) within the ECL provision of £1.2m in relation to climate change. Estimates and judgements are regularly reviewed based on past experience, expectations of future events and other factors.

Judgements

The Company has made the following key judgements in applying the accounting policies:

i) Loan book impairments

Significant increase in credit risk for classification in stage 2

The Group's SICR rules considers changes in default risk, internal impairment measures, changes in customer credit bureau files, or whether forbearance measures had been applied. As the COVID-19 payment deferrals initiative has ceased, newly granted payment holidays are considered a SICR event.

Other SICR adjustments made during the pandemic to account for high risk accounts have since been removed with SICR adjustments updated as the Group identified increases in credit risk as a result of the Cost of Living and Cost of Borrowing stresses in the UK, caused by high inflation and increases in interest rates.

ii) Business model

Application of the 'business model' requirements under IFRS 9 requires the Company to conclude on the business models that it operates and is a fundamental aspect in determining the classification of the Company's financial assets.

Management considered the manner in which the Company manages its financial assets by reference to how the performance of the assets is evaluated and their performance measured, the risks that affect the performance of the assets and how these are managed.

The Company had a dual business model at the start of the year originating mortgages within a hold-to-collect-and-sell (HTCAS) and within a hold-to-collect (HTC) model. The originating mortgages on a HTCAS basis ceased from February 2022. Mortgage assets originated within the HTCAS business model pre February 2022 continue to be recognised at FVOCI.

The Audit Committee has considered the business model assessment of IFRS 9 and agreed with management's conclusions on the business model.

2. Judgements in applying accounting policies and critical accounting estimates (continued)

The Company had one business models from February 2022 being a 'held to collect' business model with Loan and Advances assets held at amortised cost. This conclusion was reached on the basis that the Company originates in order to collect contractual cash flows over the life of the originated instrument.

Management also concluded that the Company's had a secondary business model on a 'held to collect and sell' basis through to February 2022 with a portion of the Company's assets held at FVOCI. This conclusion was reached on the basis that customer loans may on occasion be sold to fellow subsidiaries with the intention thereafter to securitise the assets; such sales are expected to be a relatively small proportion of total loan assets. This business model ceased from February 2022 due to the intention to securitise assets direct from the Company's balance sheet replacing selling to a fellow subsidiary.

Estimates

The Company has made the following estimates in the application of the accounting policies that have a significant risk of material adjustment to the carrying amount of assets and liabilities within the next financial year:

i) Fair values of the residential mortgages at FVOCI

The fair values of the residential mortgages at FVOCI (see note 16) are calculated using an expected cash flow model, including assumptions on expected repayments rates and expected credit losses. Expected future principal and interest cash flows are discounted using a rate of 1 month SONIA plus a margin, where the margin is a function of credit spread and lender commercial margin.

Determining discount rates in fair value models is a key area of judgment. The fair value calculation is sensitive to the credit spreads embedded in the discount rates applied. An increase of 0.50% in the discount rate results in a decrease of £8.7m (2021: £14.4m) to the fair value of residential mortgages at FVOCI. A decrease of 0.50 % in the discount rate results in an increase of £9.0m (2021: £14.9m) to the fair value of residential mortgages at FVOCI.

ii) Effective interest rate on organic lending

Estimates are made when calculating the EIR for newly originated loan assets. These include the likely customer redemption profiles.

Mortgage products offered by the Company include directly attributable net fee income and a period on reversion rates after the fixed/discount period, products revert to a LIBOR/Base plus a margin. The Company uses historical customer behaviours, expected take-up rate of retention products and macroeconomic forecasts in its assessment of prepayment rates. Customer prepayments in a fixed rate or incentive period can give rise to Early Repayment Charge (ERC) income.

Estimation is used in assessing whether and for how long mortgages that reach the end of the initial product term stay on reversion rates, and to the quantum and timing of prepayments that incur ERCs. The estimate of customer weighted average life will determine the period over which net fee income and expected reversionary income is recognised. Estimates are reviewed regularly and, as a consequence of the reviews, adjustments of £41.6m were made in 2022, decreasing net interest income and customer loans and receivables (2021: decrease of £14.7m).

2. Judgements in applying accounting policies and critical accounting estimates (continued)

There were a number of base rate rises in quick succession in 2022, increasing the sensitivity to changes in behavioural assumptions because higher reversion rates both increase the income earned on loans in the reversion period and can lead to higher repayment rates and therefore less time spent on reversion.

A three months' reduction in the weighted average lives of loans in the reversion period was considered to be a reasonably possible change in assumption based on observed changes in repayment rates in reversion periods over the last two years and what could happen to repayment rates in a high interest rate environment and an uncertain macroeconomic outlook.

Applying a three month reduction to the expected weighted average life of the loan book in the reversion period would result in a reset loss of c.£48.3m in 2023 (2021: c.£29.3m on a six month basis in 2022).

iii) Loan book impairments

Set out below are details of the critical accounting estimates which underpin loan impairment calculations. Less significant estimates are not discussed as they do not have a material effect. The Company has recognised total impairment (excluding pipeline) of £26.3m (2021: £17.9m impairment) at the reporting date as disclosed in note 17.

Modelled impairment

Modelled provision assessments are also subject to estimation uncertainty, underpinned by a number of estimates being made by management which are utilised within impairment calculations. Key areas of estimation within modelled provisioning calculations include those regarding the LGD and forward-looking macroeconomic scenarios.

Loss given default model

The Company has a number of LGD models, which include estimates regarding propensity to go to possession given default (PPD), forced sale discount, time to sale and sale costs. The LGD is sensitive to the application of the HPI, with a 10% haircut seen to be a reasonable percentage change when reviewing historical and expected 12 month outcomes. The resulting incremental provision required in a 10% house price haircut being directly applied to all exposures which not only adjust the sale discount but the propensity to go to PPD, as at 31 December, would result in an incremental £11.2m (2021: £8.2m) of provision being required.

The Company's forecasts of HPI movements used in the impairment models are disclosed in the Principal risks and uncertainties on page 8.

Forward-looking macroeconomic scenarios

The forward-looking macroeconomic scenarios affect all model components of the ECL thus the calculation remains sensitive to both the scenarios utilised and their associated probability weightings.

The Company has adopted an approach which utilises four macroeconomic scenarios. These scenarios are provided by an industry leading economics advisory firm, that provide management and the Board with advice on which scenarios to utilise and the probability weightings to attach to each scenario. A base case forecast is provided, together with a plausible upside scenario. Two downside scenarios are also provided (downside and a severe downside). The Company's macroeconomic scenarios can be found in the Credit Risk section of the Principal risks and uncertainties section on page 8.

2. Judgements in applying accounting policies and critical accounting estimates (continued)

The following tables detail the ECL scenario sensitivity analysis with each scenario weighted at 100% probability. The purpose of using multiple economic scenarios is to model the non-linear impact of assumptions surrounding macroeconomic factors and ECL calculated:

At 31 December 2022	**Weighted (see note 17)**	**100% Base case scenario**	**100% Upside scenario**	**100% Downside scenario**	**100% Severe downside scenario**
Total mortgages before provisions, £m	**9,536.9**	**9,536.9**	**9,536.9**	**9,536.9**	**9,536.9**
Modelled ECL, £m	**13.7**	**10.2**	**8.1**	**20.2**	**31.0**
Non-modelled ECL, £m	**12.6**	**12.6**	**12.6**	**12.6**	**12.6**
Total ECL, £m	**26.3**	**22.8**	**20.7**	**32.8**	**43.6**
ECL coverage, %	**0.28**	**0.24**	**0.22**	**0.34**	**0.46**

At 31 December 2021	Weighted (see note 17)	100% Base case scenario	100% Upside scenario	100% Downside scenario	100% Severe downside scenario
Total mortgages before provisions, £m	7,843.9	7,843.9	7,843.9	7,843.9	7,843.9
Modelled ECL, £m	8.5	4.2	2.4	13.4	21.6
Non-modelled ECL, £m	9.4	9.4	9.4	9.4	9.4
Total ECL, £m	17.9	13.6	11.8	22.8	31.0
ECL coverage, %	0.23	0.17	0.15	0.29	0.40

3. Interest receivable and similar income

	2022 £m	2021 £m
At amortised cost:		
On mortgages	**365.4**	287.5
On investment securities	**4.7**	2.1
On other liquid assets	**17.4**	1.2
Amortisation of fair value adjustments on hedged assets[1]	**(16.4)**	(18.3)
	371.1	272.5
At FVTPL		
Net income/(expense) on derivative financial instruments - lending activities	**56.7**	(17.1)
At FVOCI:		
On mortgages	**37.5**	45.1
On investment securities	**-**	0.3
	465.3	300.8

1. The amortisation relates to hedged assets where the hedges were terminated before maturity and were effective at the point of termination.

4. Interest payable and similar charges

	2022 £m	2021 £m
At amortised cost:		
On retail deposits	**118.1**	72.7
On BoE borrowings	**28.9**	1.8
On wholesale borrowings	**1.8**	0.8
On lease liabilities	**0.1**	0.2
Amortisation of fair value adjustments on hedged liabilities[1]	**(1.7)**	(1.7)
	147.2	73.8
At FVTPL		
Net expense/(income) on derivative financial instruments - savings activities	**14.6**	(3.0)
	161.8	70.8

1. The amortisation relates to hedged liabilities where the hedges were terminated before maturity and were effective at the point of termination.

5. Fair value gains on financial instruments

	2022 **£m**	2021 £m
Fair value changes in hedged assets	**(290.0)**	(135.2)
Hedging of assets	**290.2**	134.9
Fair value changes in hedged liabilities	**8.3**	15.6
Hedging of liabilities	**(9.9)**	(14.6)
Ineffective portion of hedges	**(1.4)**	0.7
Net gains on unmatched swaps	**43.4**	6.0
Amortisation of inception adjustments[1]	**1.5**	4.6
Fair value movements on mortgages at FVTPL	**(0.9)**	1.2
Debit and credit valuation adjustment	**(0.4)**	(0.6)
	42.2	11.9

1. The amortisation of inception adjustments relates to the amortisation of the hedging adjustments arising when hedge accounting commences, primarily on derivative instruments previously taken out against the mortgage pipeline and also on derivative instruments previously taken out against new retail deposits.

6. Gain on sale of financial instruments

There were no sales of financial instruments during the year ended 31 December 2022.

On 10 February 2021, the Company sold the Precise Mortgage Funding 2019-1B A2 notes for £287.0m, generating a gain on sale of £2.4m.

7. Other operating income

	2022 **£m**	2021 £m
Income received on mortgages at FVTPL	**0.6**	0.5
Fees and commissions receivable	**1.6**	1.1
	2.2	1.6

8. Administrative expenses

	2022	2021
	£m	£m
Facilities costs	**1.3**	1.3
Marketing costs	**0.6**	0.5
Research and development costs	**1.1**	1.9
Support costs	**10.7**	10.6
Professional fees	**3.1**	4.1
Other costs[1]	**55.0**	44.0
Depreciation (see note 22)	**1.7**	1.7
Amortisation (see note 23)	**1.7**	1.6
	75.2	65.7

1. Other costs includes £49.5m services cross charge from Group (2021: £43.7m).

Included in professional fees are amounts paid to the Company's auditor as follows:

	2022	2021
	£'000	£'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**860**	796
Total audit fees	**860**	796
Audit-related assurance services[1]	**11**	11
Other non-audit services[2]	**-**	10
Total non-audit fees	**11**	21
Total fees payable to the Company's Auditor	**871**	817

1. Relates to assurance reviews of profit verification.
2. Relates to work on AT1 securities issuance.

9. Integration costs

	2022	2021
	£m	£m
Consultant fees	**0.2**	0.1
Staff costs	**0.6**	0.9
	0.8	1.0

Following the acquisition of Charter Court Financial Services Group Plc (CCFSG) by OneSavings Bank plc (OSB) in October 2019, integration costs are the post-acquisition costs incurred in integrating the operations of OSB and CCFSG. The three year integration programme has now completed in 2022.

10. Staff costs

The Company has no employees (2021: none). Services to the Company are provided by employees across the Group. The Company pays servicing fees to OSB and Exact Mortgage Experts Limited (EME) for management services provided, as disclosed further in note 37.

All of the Directors of the Company are also directors of the Group with the exception of Rodney Duke.

The Directors were employed and remunerated as Directors or employees of the Group in respect of their services to the Group as a whole and the costs have been allocated to the main lending entities in the Group including the Company. The cross charge applied from the Group for the Company Directors is £1,853k (2021 £1,803k).

The total Directors' emoluments in this note are for services provided as Directors of the Company and for services provided as Directors or employees of the Group as a whole prior to the cost allocation applied:

	2022 **£'000**	2021 £'000
Short-term employee benefits[1]	**2,665**	2,462
Post-employment benefits	**109**	106
Share-based payments[2]	**2,292**	1,267
	5,066	3,835

1. Short-term employee benefits comprise Directors' salary costs, Non-Executive Directors' fees and other short-term incentive benefits, which are disclosed in the Annual Report on Remuneration.
2. Share-based payments represent the amounts received by Directors for schemes that vested during the year.

In addition to the total Directors' emoluments above, the two Executive Directors were granted deferred bonuses of £642k (2021: £633k) in the form of shares. DSBP awards granted from April 2021 have a holding period from three years up to seven years with no further conditions attached other than standard clawback situations. In March 2020 and prior years, the DSBP awards were subject to either a three or five year vesting period with conditions attached, notably if the Director leaves prior to vesting, the award is forfeited unless a good leaver reason applies such as redundancy, retirement or ill-health.

The two Executive Directors received a further share award under the Performance Share Plan (PSP) with a grant date fair value of £1,516k (2021: £1,458k) using a share price of £5.58 (2021: £4.94) (the mid-market quotation on the day preceding the date of grant). These shares vest annually from year three in tranches of 20%, subject to performance conditions discussed in note 11 of OSBG Annual Report and Accounts and the OSBG Annual Report on Remuneration.

For further details on the share awards see the OSBG Annual Report on Remuneration.

No compensation was paid for loss of office during 2022 and 2021.

There were no outstanding loans granted in the ordinary course of business to Directors and their connected persons as at 31 December 2022 and 2021.

The highest paid Director employed by the Group received emoluments of £2,991k (2021: £2,506k) and payments in respect of personal pension plans of £67k (2021: £65k) in the year.

11. Taxation

The table below shows the components of the Company's tax charge for the year:

	2022 £m	2021 £m
Corporation tax	**69.2**	49.3
Deferred tax	**(0.1)**	0.3
Tax in respect of prior periods	**-**	(0.1)
Total tax	**69.1**	49.5

The charge for taxation on the Company's profit before taxation differs from the charge based on the standard rate of UK Corporation Tax of 19% (2021: 19%) as follows:

	2022 £m	2021 £m
Profit before tax	**263.3**	187.4
Profit multiplied by the standard rate of UK Corporation Tax	**50.0**	35.6
Bank surcharge	**19.8**	13.9
Tax effects of:		
Adjustments in respect of earlier years	**-**	(0.1)
Impact of deferred tax rate change	**-**	0.1
Tax on coupon paid on AT1 securities	**(0.7)**	-
Total tax charge	**69.1**	49.5

The effective tax rate for the year ended 31 December 2022 is 26.2% (2021: 26.4%).

Factors that may affect future tax charges

On 24 May 2021, the government substantively enacted legislation to increase the corporation tax rate from 19% to 25% from 1 April 2023. Further, on 24 February 2022, the government substantively enacted legislation to decrease the bank surcharge rate from 8% to 3% from 1 April 2023, together with an increase in the surcharge annual allowance (the level of taxable profits above which are subject to the surcharge) from £25m to £100m.

In September 2022, the government announced that the above changes would be cancelled, but then in October 2022 announced that the changes would go ahead as enacted.

Deferred tax expected to unwind after 1 April 2023 is recognised at the bank surcharge rate of 28% (2021: 33%).

12. Dividends

	2022		2021	
	£m	Pence per share	£m	Pence per share
Final dividend for the prior year	17.5	609.8	-	-
Interim dividend for the current year	17.7	616.7	-	-
Dividends paid to fund OSBG's share repurchase programme	40.0	1,393.7	-	-
Total dividend paid	75.2		-	-

13. Cash and cash equivalents

The following table analyses the cash and cash equivalents disclosed in the Statement of Cash Flows:

	2022 £m	2021 £m
Unencumbered loans and advances to credit institutions	1,479.2	1,182.9
Investment securities[1]	-	100.0
	1,479.2	1,282.9

1. Investment securities with maturities of less than three months from date of acquisition.

14. Loans and advances to credit institutions

	2022 £m	2021 £m
Unencumbered:		
BoE call account	1,478.3	1,182.9
Call accounts	0.9	-
Encumbered:		
BoE cash ratio deposit	25.0	23.0
Cash margin given	127.8	63.2
	1,632.0	1,269.1

All loans and advances to credit institutions held by the Company are denominated in Pounds Sterling.

15. Investment securities

	2022 £m	2021 £m
Held at amortised cost:		
UK Sovereign debt	**-**	100.0
RMBS loan notes	**201.6**	223.1
	201.6	323.1
Less: Expected credit losses	**-**	-
	201.6	323.1
Held at FVOCI:		
UK Sovereign debt	**-**	152.0
RMBS loan notes	**0.7**	2.7
	0.7	154.7
	202.3	477.8

At 31 December 2022, the Company had no RMBS held at FVOCI (2021: nil) and £11.5m of RMBS held at amortised cost (2021: £119.5m) sold under repos.

The Directors consider that the primary purpose of holding investment securities is prudential. These securities are held as liquid assets with the intention of use on a continuing basis in the Company's activities and are classified as amortised cost and FVOCI in accordance with the Company's business model for each security.

The credit risk on investment securities held at amortised cost has not significantly increased since initial recognition and are categorised as stage 1. The ECLs are less than £0.1m.

Movements during the year of investment securities are analysed as follows:

	2022 £m	2021 £m
At 1 January	**477.8**	460.7
Additions[1]	**40.2**	552.1
Disposals and maturities[2]	**(314.5)**	(535.8)
Amortisation	**(0.8)**	(0.3)
Movement in accrued interest	**(0.4)**	0.7
Changes in fair value	**-**	0.4
At 31 December	**202.3**	477.8

1. 2021 additions includes £100.0m of UK Treasury bills (2022 £nil) which had a maturity of less than three months from date of acquisition.
2. Disposals and maturities includes £100.0m of UK Treasury bills which had a maturity of less than three months from date of acquisition (2021: nil).

16. Loans and advances to customers

	2022 £m	2021 £m
Held at amortised cost:		
Loans and advances	**9,536.9**	7,843.9
Held at FVOCI:		
Residential mortgages	**735.7**	945.6
	10,272.6	8,789.5
Less: Expected credit losses (see note 17)	**(26.3)**	(17.9)
	10,246.3	8,771.6
Held at FVTPL:		
Residential mortgages	**14.6**	17.7
	10,260.9	8,789.3

Gross carrying amount	2022 £m	2021 £m
Held at amortised cost:		
Stage 1	**7,319.8**	6,570.3
Stage 2	**2,053.4**	1,157.5
Stage 3	**162.7**	114.8
Stage 3 POCI	**1.0**	1.3
	9,536.9	7,843.9
Held at FVOCI:		
Stage 1	**577.3**	831.0
Stage 2	**150.2**	108.2
Stage 3	**8.2**	6.4
	735.7	945.6

Encumbered assets

The residential mortgage loans pledged as collateral for liabilities are shown in the table below:

	2022 £m	2021 £m
BoE under TFSME and Indexed Long-Term Repo (ILTR)	**3,144.5**	2,496.7

The Company's securitisation programme and use of the TFSME and ILTR results in certain assets being encumbered as collateral against such funding. Assets that are encumbered cannot be used for other purposes. As at 31 December 2022 the percentage of loans and advances to customers that are encumbered was 30.6% (2021: 28.4%).

16. Loans and advances to customers (continued)

Loans and advances at amortised cost

The table below shows the movement in loans and advances held at amortised cost by IFRS 9 stage during the year:

Held at amortised cost	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 3 (POCI) £m	Total £m
At 1 January 2021	5,694.2	1,270.7	78.7	1.4	7,045.0
Originations[1]	1,836.2	-	-	-	1,836.2
Repayments and write-offs[2]	(1,036.9)	(0.2)	(0.1)	(0.1)	(1,037.3)
Transfers between stages					
- To Stage 1	695.1	(675.5)	(19.6)	-	-
- To Stage 2	(606.4)	614.9	(8.5)	-	-
- To Stage 3	(11.9)	(52.4)	64.3	-	-
At 31 December 2021	6,570.3	1,157.5	114.8	1.3	7,843.9
Originations[1]	**2,960.8**	**-**	**-**	**-**	**2,960.8**
Repayments and write-offs[2]	**(1,085.1)**	**(167.2)**	**(15.2)**	**(0.3)**	**(1,267.8)**
Transfers between stages					
- To Stage 1	**516.7**	**(514.0)**	**(2.7)**	**-**	**-**
- To Stage 2[3]	**(1,622.1)**	**1,632.3**	**(10.2)**	**-**	**-**
- To Stage 3	**(20.8)**	**(55.2)**	**76.0**	**-**	**-**
At 31 December 2022	**7,319.8**	**2,053.4**	**162.7**	**1.0**	**9,536.9**

1. Originations include further advances and drawdowns on existing commitments.
2. Repayments and write-offs include customer redemptions.
3. The increase in balance of accounts in Stage 2 is due to the increased credit risk from heightened cost of living and cost of borrowing.

The contractual amount outstanding on loans and advances to customers that were written off during the reporting period and are still subject to collections and recovery activity is £0.1m at 31 December 2022 (2021: £0.3m).

As at 31 December 2022 £37.4m of loans and advances (2021: £20.7m) are in a probation period before they can move out of Stage 3, see note 1 m) for further details.

Residential mortgages held at fair value through other comprehensive income

The residential mortgage portfolio held at FVOCI is categorised as level 3. The fair value is based on expected future cash flows using an assumed amortisation profile of the pool of mortgages. The cash flows are discounted to present value using zero coupon rates.

16. Loans and advances to customers (continued)

The table below shows the movement in residential mortgages held at FVOCI by IFRS 9 stage during the year:

Held at FVOCI	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2021	571.8	80.5	3.7	656.0
Originations[1]	323.9	-	-	323.9
Repayments and write-offs[2]	(29.6)	(4.5)	(0.2)	(34.3)
Transfers between stages				
- To Stage 1	38.0	(37.7)	(0.3)	-
- To Stage 2	(72.0)	72.5	(0.5)	-
- To Stage 3	(1.1)	(2.6)	3.7	-
At 31 December 2021	831.0	108.2	6.4	945.6
Originations[1]	**9.1**	**-**	**-**	**9.1**
Repayments and write-offs[2]	**(188.3)**	**(28.8)**	**(1.9)**	**(219.0)**
Transfers between stages				
- To Stage 1	**49.2**	**(49.2)**	**-**	**-**
- To Stage 2	**(121.6)**	**122.2**	**(0.6)**	**-**
- To Stage 3	**(2.1)**	**(2.2)**	**4.3**	**-**
At 31 December 2022	**577.3**	**150.2**	**8.2**	**735.7**

1. Originations include further advances and drawdowns on existing commitments.
2. Repayments and write-offs include customer redemptions.

The Company undertakes a regular review of FVOCI residential mortgages to identify any adjustments to their fair values.

No loss allowance or EIR adjustment is recognised in the Statement of Financial Position for loans and advances to customers measured at FVOCI as the carrying amount is at fair value. At 31 December 2022 a loss allowance of £1.6m (2021: £1.4m) and EIR adjustments of £8.3m (2021: £(5.3)m) on residential mortgages held at FVOCI have been recognised through other comprehensive income.

Residential mortgages held at fair value through profit and loss

The residential mortgage portfolio held at fair value through profit and loss is categorised as level 3. The fair value is based on expected future cash flows using an assumed amortisation profile of the pool of mortgages.

16. Loans and advances to customers (continued)

The expected future cash flows are discounted to present value using risk adjusted rates. Movements in the residential mortgages held at FVTPL during the year were:

	2022 £m	2021 £m
At 1 January	**17.7**	19.1
Repayments and redemptions	**(2.8)**	(3.1)
Interest received on mortgages	**0.6**	0.5
Fair value movements on mortgages	**(0.9)**	1.2
At 31 December	**14.6**	17.7

17. Expected credit losses

ECL for residential mortgages held at amortised cost are recognised within the carrying value of the mortgages (see note 16). ECL for residential mortgages held at FVOCI are recognised within other comprehensive income.

Impairment provisions on residential mortgages at amortised cost

The ECL has been calculated based on various scenarios as set out below:

	ECL provision 2022 £m	**Weighting 2022 %**	**Weighted ECL provision 2022 £m**	ECL provision 2021 £m	Weighting 2021 %	Weighted ECL provision 2021 £m
Scenarios						
Upside	**8.1**	**30**	**2.4**	2.4	20	0.5
Base case	**10.2**	**40**	**4.1**	4.2	40	1.7
Downside scenario	**20.2**	**20**	**4.1**	13.4	28	3.7
Severe downside scenario	**31.0**	**10**	**3.1**	21.6	12	2.6
Total weighted provisions			**13.7**			8.5
Non-modelled Provisions:						
Individually assessed provisions			**1.8**			1.9
Post model adjustments			**10.8**			7.5
Total provision			**26.3**			17.9

17. Expected credit losses (continued)

The Company reflected on the ongoing appropriateness of probabilities attached to the suite of IFRS 9 scenarios as the macroeconomic outlook evolved throughout the year. Scenarios were adjusted to a symmetrical probability, where the upside and downside scenarios carry equal weightings, as a result of separate post-model adjustments being raised to ensure that the current IFRS 9 framework adequately provisioned for the underlying portfolio risk.

As at 31 December 2022, the Company identified increases in credit risk as a result of the cost of living and cost of borrowing stresses caused by high inflation and increases in interest rates. As a result, the Company held an additional £7.0m of ECL in PMA for risks not sufficiently accounted for in the IFRS 9 framework (£2.5m for cost of living and £4.5m for cost of borrowing) as at 31 December 2022. The approach to identify the PMA for the cost of living is an increase in PD through analysing the effect of the increases in living costs, such as house hold bills and groceries, on affordability, which is used to increase the default risk to all customers, with those on lower income more impacted. The cost of borrowing PMA specifically identified those that are more at risk of default due to reverting onto variable rate in the near future, causing a payment increase and higher affordability risk, which is used both to apply an additional significant increase in credit risk SICR and stage 2 criteria and in some cases a higher default risk.

The Company continued to observe an elongated time to sale, which was in excess of modelled expectations and observations prior to the pandemic which accounted for an additional £2.2m as a PMA as at 31 December 2022. Whilst the Company expects the process delays to reduce in time, a PMA was held to reflect an extended time to sale in line with most recent observations for those in default.

As part of the Company's appreciation of climate risk and overall ESG agenda, the Company recognises that properties with lower energy efficiency are likely to require investment to reach minimum energy efficiency standards in the future. As a result, to reflect the expected transition risk and physical risks of climate change, the Company held £1.2m of PMA as at 31 December 2022.

To reflect the ongoing cladding concerns, the Company identified a valuation risk to a small number of properties and accounted for a further sale discount for these properties by a PMA of £0.4m as at 31 December 2022.

17. Expected credit losses (continued)

The table below shows the movement in the ECL by IFRS 9 stage during the year. ECLs on originations and acquisitions reflect the IFRS 9 stage of loans originated or acquired during the year as at 31 December and not the date of origination. Re-measurement of loss allowance relates to existing loans which did not redeem during the year and includes the impact of loans moving between IFRS 9 stages.

Held at amortised cost:	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 3 (POCI) £m	Total £m
At 1 January 2021	7.8	13.3	4.4	0.1	25.6
Originations	0.8	-	-	-	0.8
Repayments and write-offs	(1.8)	(1.6)	(1.2)	-	(4.6)
Re-measurement of loss allowance	(8.5)	3.1	1.5	-	(3.9)
Transfers:					
- To Stage 1	4.9	(4.8)	(0.1)	-	-
- To Stage 2	(0.8)	1.0	(0.2)	-	-
- To Stage 3	-	(0.8)	0.8	-	-
At 31 December 2021	2.4	10.2	5.2	0.1	17.9
Originations	**1.4**	**-**	**-**	**-**	**1.4**
Repayments and write-offs	**(0.4)**	**(1.2)**	**(1.2)**	**-**	**(2.8)**
Re-measurement of loss allowance	**(5.4)**	**10.5**	**4.7**	**-**	**9.8**
Transfers:					
- To Stage 1	**3.8**	**(3.8)**	**-**	**-**	**-**
- To Stage 2	**(0.6)**	**0.9**	**(0.3)**	**-**	**-**
- To Stage 3	**-**	**(0.8)**	**0.8**	**-**	**-**
At 31 December 2022	**1.2**	**15.8**	**9.2**	**0.1**	**26.3**

The tables below show the stage 2 ECL balances by transfer criteria:

	2022			2021		
	Carrying value £m	**ECL £m**	**Coverage %**	Carrying value £m	ECL £m	Coverage %
Criteria:						
Relative PD movement	**1,621.6**	**14.4**	**0.89**	725.1	8.0	1.10
Qualitative measures	**422.9**	**1.4**	**0.33**	415.1	2.1	0.51
30 days past due backstop	**8.9**	**-**	**-**	17.3	0.1	0.58
Total	**2,053.4**	**15.8**	**0.77**	1,157.5	10.2	0.88

The Company has a number of qualitative measures to determine whether a SICR has taken place. These triggers utilise both internal performance information, to analyse whether an account is in distress but not yet in arrears, and external credit bureau information, to determine whether the customer is experiencing financial difficulty with an external credit obligation.

17. Expected credit losses (continued)

Impairment provisions on residential mortgages held at FVOCI

The table below shows the movement in the ECL by IFRS 9 stage during the year. ECLs on originations and acquisitions reflect the IFRS 9 stage of loans originated or acquired during the year as at 31 December and not the date of origination. Re-measurement of loss allowance relates to existing loans which did not redeem during the year and includes the impact of loans moving between IFRS 9 stages. ECL for residential mortgages held at FVOCI are recognised within other comprehensive income.

Held at FVOCI	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
At 1 January 2021	0.7	0.8	0.4	1.9
Originations	0.1	0.1	-	0.2
Repayments and write-offs	-	(0.1)	(0.2)	(0.3)
Re-measurement of loss allowance	(0.7)	0.3	-	(0.4)
Transfers:				
- To Stage 1	0.4	(0.4)	-	-
- To Stage 2	(0.1)	0.1	-	-
At 31 December 2021	0.4	0.8	0.2	1.4
Repayments and write-offs	**-**	**(0.1)**	**-**	**(0.1)**
Re-measurement of loss allowance	**(0.6)**	**0.5**	**0.4**	**0.3**
Transfers:				
- To Stage 1	**0.4**	**(0.4)**	**-**	**-**
- To Stage 2	**(0.1)**	**0.1**	**-**	**-**
At 31 December 2022	**0.1**	**0.9**	**0.6**	**1.6**

18. Impairment of financial assets

The charge/(credit) for impairment of financial assets in the Consolidated Statement of Comprehensive Income comprises:

	2022	2021
	£m	£m
Write-offs in year	**0.1**	0.2
Increase/(decrease) in provision:		
- On mortgages at amortised cost	**8.4**	(7.7)
- On mortgages at FVOCI	**0.2**	(0.5)
- On undrawn loan facilities	**(0.1)**	(0.1)
	8.6	(8.1)

19. Derivatives

The table below reconciles the gross amount to derivative contracts to the carrying balance shown in the Statement of Financial Position.

	Gross amount of recognised financial assets / (liabilities)	**Net amount of financial assets / (liabilities) presented in the Statement of Financial Position**	**Contracts subject to master netting agreements not offset in the Statement of Financial Position**	**Cash collateral paid / (received) not offset in the Statement of Financial Position**	**Net amount**
	£m	**£m**	**£m**	**£m**	**£m**
At 31 December 2022					
Derivative assets:					
Interest rate risk hedging	**447.2**	**447.2**	**(41.7)**	**(372.3)**	**33.2**
Derivative liabilities:					
Interest rate risk hedging	**(42.8)**	**(42.8)**	**41.7**	**127.5**	**126.4**
At 31 December 2021					
Derivative assets:					
Interest rate risk hedging	86.9	86.9	(10.7)	(73.3)	2.9
Derivative liabilities:					
Interest rate risk hedging	(11.3)	(11.3)	10.7	63.2	62.6

Derivative assets and liabilities include an initial margin of £119.5m with swap counterparties.

There are no derivatives not covered by master netting agreements.

19. Derivatives (continued)

The tables below profile the maturity of nominal amounts for interest rate risk hedging derivatives based on contractual maturity:

	Total nominal £m	Less than 3 months £m	3 - 12 months £m	1 - 5 years £m	More than 5 years £m
At 31 December 2022					
Derivative assets	**7,391.0**	**402.5**	**1,638.0**	**5,258.5**	**92.0**
Derivative liabilities	**4,360.0**	**853.0**	**2,731.0**	**671.0**	**105.0**
	11,751.0	**1,255.5**	**4,369.0**	**5,929.5**	**197.0**
At 31 December 2021					
Derivative assets	5,973.0	65.0	1,009.0	4,835.0	64.0
Derivative liabilities	3,962.0	735.0	2,407.0	800.0	20.0
	9,935.0	800.0	3,416.0	5,635.0	84.0

The Company has 787 (2021: 729) derivative contracts with an average fixed rate of 1.41% (2021: 0.34%).

20. Hedge accounting

	2022 £m	2021 £m
Hedged assets		
Current hedge relationships	**(419.8)**	(87.2)
Swap inception adjustment	**35.3**	(6.6)
Cancelled hedge relationships	**9.0**	25.4
	(375.5)	(68.4)
Hedged liabilities		
Current hedge relationships	**23.1**	11.0
Swap inception adjustment	**(1.6)**	1.9
Cancelled hedge relationships	**(0.8)**	(2.5)
De-designated hedge relationships	**-**	(1.8)
	20.7	8.6

The swap inception adjustment relates to hedge accounting adjustments arising when hedge accounting commences, primarily on derivative instruments previously taken out against the mortgage pipeline and on derivative instruments previously taken out against new retail deposits.

De-designated hedge relationships relates to hedge accounting adjustments on failed hedge accounting relationships. These adjustments are amortised over the remaining lives of the original hedged items.

Cancelled hedge relationships predominantly represent the unamortised fair value adjustment for interest rate risk hedges that have been cancelled and replaced due to securitisation activities, legacy long-term fixed rate mortgages (c. 25 years at origination) and during 2021 IBOR transition.

The table below analyses the Company's portfolio hedge accounting for fixed rate loans and advances to customers.

	2022		2021	
Loans and advances to customers	**Hedged item £m**	**Hedging instrument £m**	Hedged item £m	Hedging instrument £m
Carrying amount of hedged item/nominal value of hedging instrument	**7,019.1**	**7,018.0**	6,269.5	6,275.0
Cumulative fair value adjustments of hedged item/fair value of hedging instrument	**(419.8)**	**430.5**	(87.2)	86.1
Changes in the fair value adjustment of hedged item/hedging instrument used for recognising the hedge ineffectiveness for the period	**(290.0)**	**290.2**	(135.2)	134.9
Cumulative fair value on cancelled hedge relationships	**9.0**	**-**	25.4	-

20. Hedge accounting (continued)

In the Statement of Financial Position, £434.5m (2021: £86.3m of hedging instruments were recognised within derivative assets; and £(4.0)m (2021: £(0.2)m) recognised within derivative liabilities.

The movement in cancelled hedge relationships is as follows:

Hedged assets	2022 £m	2021 £m
At 1 January	**25.4**	43.0
New cancellations	**-**	0.7
Amortisation	**(16.4)**	(18.3)
At 31 December	**9.0**	25.4

The tables below analyse the Company's portfolio hedge accounting for fixed rate amounts owed to retail depositors.

	2022		2021	
Customer deposits	**Hedged item £m**	**Hedging instrument £m**	Hedged item £m	Hedging instrument £m
Carrying amount of hedged item/nominal value of hedging instrument	**3,967.6**	**3,980.0**	3,298.1	3,300.0
Cumulative fair value adjustments of hedged item/fair value of hedging instrument	**23.1**	**(25.4)**	11.0	(10.0)
Changes in the fair value adjustment of hedged item/hedging instrument used for recognising the hedge ineffectiveness for the period	**8.3**	**(9.9)**	15.6	(14.6)

In the Statement of Financial Position, £1.8m (2021: £0.1m) of hedging instruments were recognised within derivative assets; and £27.2m (2021: £(10.1)m) recognised within derivative liabilities.

21. Other assets

	2022 £m	2021 £m
Falling due within one year:		
Prepayments	**1.2**	1.2
Amounts owed by Group undertakings	**1.5**	2.0
Other assets	**0.7**	1.0
Falling due more than one year:		
Prepayments	**0.4**	0.3
	3.8	4.5

Amounts owed by Group undertakings includes £0.6m (2021: £2.0m) receivable from EME for management services overpayment, £0.7m (2021: nil) receivable from OSB for management services overpayment and £0.1m receivable each from Broadlands Finance Limited and Charter Mortgages Limited, as disclosed in note 37.

22. Property, plant and equipment

			Right of use assets		
	Leasehold improvements £m	Equipment and fixtures £m	Property leases £m	Other leases £m	Total £m
Cost					
At 1 January 2021	0.4	3.4	7.9	0.3	12.0
Additions	-	1.4	-	-	1.4
Disposals and write-offs[1]	-	(0.1)	-	(0.3)	(0.4)
At 31 December 2021	0.4	4.7	7.9	-	13.0
Additions	**-**	**0.2**	**0.5**	**-**	**0.7**
Disposals and write-offs[1]	**-**	**(0.2)**	**-**	**-**	**(0.2)**
At 31 December 2022	**0.4**	**4.7**	**8.4**	**-**	**13.5**
Depreciation					
At 1 January 2021	0.2	1.5	1.7	0.2	3.6
Charged in year	-	0.8	0.8	0.1	1.7
Disposals and write-offs[1]	-	(0.1)	-	(0.3)	(0.4)
At 31 December 2021	0.2	2.2	2.5	-	4.9
Charged in year	**-**	**0.8**	**0.8**	**0.1**	**1.7**
Disposals and write-offs[1]	**-**	**(0.2)**	**-**	**-**	**(0.2)**
At 31 December 2022	**0.2**	**2.8**	**3.3**	**0.1**	**6.4**
Net book value					
At 31 December 2022	**0.2**	**1.9**	**5.1**	**(0.1)**	**7.1**
At 31 December 2021	0.2	2.5	5.4	-	8.1

1. During the year the Company wrote off £(0.2)m of fully depreciated assets (2021: £(0.4)m).

23. Intangible assets

	Development costs £m	Computer software and licences £m	Total £m
Cost			
At 1 January 2021	4.7	1.7	6.4
Additions	-	0.4	0.4
Disposals and write-offs[1]	-	(0.1)	(0.1)
At 31 December 2021	4.7	2.0	6.7
Additions	**-**	**0.4**	**0.4**
Disposals and write-offs[1]	**(0.2)**	**(0.8)**	**(1.0)**
At 31 December 2022	**4.5**	**1.6**	**6.1**
Amortisation			
At 1 January 2021	0.1	0.9	1.0
Charged in year	1.2	0.4	1.6
Disposals and write-offs[1]	-	(0.1)	(0.1)
At 31 December 2021	1.3	1.2	2.5
Charged in year	**1.2**	**0.5**	**1.7**
Disposals and write-offs[1]	**(0.2)**	**(0.8)**	**(1.0)**
At 31 December 2022	**2.3**	**0.9**	**3.2**
Net book value			
At 31 December 2022	**2.2**	**0.7**	**2.9**
At 31 December 2021	3.4	0.8	4.2

1. During the year the Company wrote off fully amortised assets.

The Directors have considered the carrying value of intangible assets and determined that there are no indications of impairment at the year end.

24. Amounts owed to credit institutions

	2022 £m	2021 £m
BoE TFSME	**1,837.0**	1,824.5
BoE ILTR	**300.9**	-
Commercial repo	**10.1**	0.5
Loans from credit institutions	**-**	2.5
	2,148.0	1,827.5
Cash collateral and margin received	**376.3**	73.3
	2,524.3	1,900.8

Interest on the TFSME is charged at current bank base rate. Drawings on the TFSME each have four year terms.

25. Amounts owed to retail depositors

	2022 £m	2021 £m
Fixed rate deposits	**5,899.1**	4,701.8
Variable rate deposits	**2,724.0**	3,083.6
	8,623.1	7,785.4

26. Amounts owed to other customers

	2022 £m	2021 £m
Fixed rate deposits	**100.4**	44.5
Variable rate deposits	**12.2**	42.3
	112.6	86.8

27. Lease liabilities

	2022 **£m**	2021 £m
At 1 January	**5.6**	6.4
New leases	**0.5**	0.1
Lease terminated	**-**	(0.1)
Lease repayments	**(1.0)**	(1.0)
Interest accruals	**0.1**	0.2
At 31 December	**5.2**	5.6

During the year, the Company incurred expenses of £0.2m (2021: nil) in relation to short-term leases.

28. Other liabilities

	2022 **£m**	2021 £m
Falling due within one year:		
Accruals	**3.5**	4.0
Amounts owed to Group undertakings	**-**	1.0
Other creditors	**1.1**	0.5
	4.6	5.5

Included within amounts owed to Group undertakings in 2021 is £1.0m payable to OSB for management services and holding company services respectively, as disclosed in note 37.

29. Provisions

	2022 **£m**	2021 £m
ECL on undrawn loan facilities	**-**	0.1

Provisions for liabilities and charges represent ECL recognised on loan commitments of £455.1m (2021: £434.5m).

The Financial Services Compensation Scheme (FSCS) provides protection of deposits for the customers of authorised financial services firms, should a firm collapse. FSCS protects retail deposits of up to £85k for single account holders and £170k for joint holders. As CCFSL holds a banking licence, the full FSCS protection is available to customers of the Company.

30. Deferred tax liability/(asset)

Movement on deferred taxation balance during the year:

	Capital allowances in excess of depreciation £m	Mortgages held at fair value £m	Total £m
At 1 January 2021	0.1	3.2	3.3
Profit or loss charge	0.2	-	0.2
Tax taken directly to OCI	-	1.0	1.0
Impact of rate change - profit or loss	0.1	-	0.1
Adjustment in respect of prior years - OCI	-	(0.2)	(0.2)
At 31 December 2021	0.4	4.0	4.4
Profit or loss credit	**(0.1)**	**-**	**(0.1)**
Tax taken directly to OCI	**-**	**(9.5)**	**(9.5)**
At 31 December 2022	**0.3**	**(5.5)**	**(5.2)**

Deferred tax balances are in respect of timing differences of capital allowances in excess of depreciation and other short-term differences. The net deferred tax on FVOCI movements of £(9.5)m (2021: £0.8m) has been recognised in the Statement of Comprehensive Income and a corresponding net deferred tax liability/(asset) has been recognised.

Deferred tax has been recognised on the fair value adjustments arising on residential mortgages held at FVOCI (see note 16).

As at 31 December 2022 deferred tax assets of £(0.1)m (2021: £0.1m liability) are expected to be utilised within 12 months and £5.3m (2021: £4.3m liability) utilised after 12 months.

At 31 December 2022 and 2021, the Company had no unused tax losses.

31. Reconciliation of cash flows for financing activities

	Amounts owed to credit institutions (see note 24) £m (Restated)[1]
At 1 January 2021	1,669.2
Cash movements:	
Principal drawdowns[1]	1,826.2
Principal repayments	(1,667.9)
Interest paid	(1.8)
Non-cash movements:	
Interest charged	1.8
At 31 December 2021[1]	1,827.5
Cash movements:	
Principal drawdowns	**309.5**
Principal repayments	**(2.5)**
Interest paid	**(15.4)**
Non-cash movements:	
Interest charged	**28.9**
At 31 December 2022	**2,148.0**

1. 2021 figures restated see note 1 b) for further details.

32. Share capital

Ordinary shares - par value £1.00:	Number of shares authorised and fully paid	Nominal value £m	Premium £m
At 31 December 2021 and at 31 December 2022	**2,870,009**	**2.9**	**67.3**

No Ordinary shares were issued during the current and prior year.

The holders of ordinary shares are entitled to receive dividends as declared from time to time, and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regard to the Company’s residual assets.

All ordinary shares issued in the current and prior year were fully paid.

33. Other reserves

The Company's other reserves are as follows:

	2022 £m	2021 £m
FVOCI reserve	**16.6**	18.5
AT1 securities	**60.0**	60.0
	76.6	78.5

FVOCI reserve
The FVOCI reserve represents the cumulative net change in the fair value of loans and advances to customers and investment securities measured at FVOCI, net of deferred tax.

AT1 securities

On 7 October 2021, the Company issued AT1 securities. AT1 securities comprise £60.0m of Fixed Rate Resetting Perpetual Subordinated Securities that qualify as AT1 capital under CRD IV. The securities will pay interest at a rate of 6% per annum until the first reset date of 7 April 2027, with the reset interest rate equal to 539.3 basis points over the 5-year Gilt Rate (benchmark gilt) for such a period. Interest is paid semi-annually in April and October. The Company may, at any time, cancel any interest payment at its full discretion and must cancel interest payments in certain circumstances specified in the terms and conditions of the securities. The securities are perpetual with no fixed redemption date. The Company may, in its discretion and subject to satisfying certain conditions, redeem all (but not some) of the AT1 securities at the principal amount outstanding plus any accrued but unpaid interest from the first reset date and on any interest payment date thereafter.

34. Financial commitments and guarantees

a) The Company did not have any contracted or anticipated capital expenditure commitments not provided for as at 31 December 2022 (2021: nil).

b) The Company has no lease commitments under operating leases not subject to IFRS 16 (2021: none).

c) Undrawn loan facilities:

	2022 £m	2021 £m
Mortgages	**455.1**	434.5

Undrawn loan facilities are approved loan applications which have not yet been exercised. They are payable on demand and are usually drawn down or expire within three months.

d) The Company did not have any issued financial guarantees as at 31 December 2022 (2021: nil).

35. Risk management

Overview

Financial instruments form the vast majority of the Company's assets and liabilities.

Types of financial instrument

Financial instruments are a broad definition which includes financial assets, financial liabilities and equity instruments. The main financial assets of the Company are loans to customers and liquid assets, which in turn consist of cash in the BoE call accounts, call accounts with other credit institutions, RMBS and UK sovereign debt. These are funded by a combination of financial liabilities and equity instruments. Financial liability funding comes predominantly from retail deposits and drawdowns under the BoE TFSME and ILTR, supported by wholesale and other funding. Equity instruments include AT1 securities meeting the equity classification criteria. The Company's main activity is mortgage lending; it raises funds or invests in particular types of financial assets to meet customer demand and manage the risks arising from its operations. The Company does not trade in financial instruments for speculative purposes.

The Company uses derivative instruments to manage its financial risks. Derivative financial instruments (derivatives) are financial instruments whose value changes in response to changes in underlying variables such as interest rates. The most common derivatives are futures, forwards and swaps. Of these, the Company only uses swaps.

Derivatives are used by the Company solely to reduce (hedge) the risk of loss arising from changes in market rates. Derivatives are not used for speculative purposes.

Types of derivatives and uses

The derivative instruments used by the Company in managing its risk exposures are interest rate swaps. Interest rate swaps convert fixed interest rates to floating or vice versa. As with other derivatives, the underlying product is not sold and payments are based on notional principal amounts.

Unhedged fixed rate liabilities create the risk of paying above-the-market rate if interest rates subsequently decrease. Unhedged fixed rate mortgages and liquid assets bear the opposite risk of income below-the-market rate when rates go up. While fixed rate assets and liabilities naturally hedge each other to a certain extent, this hedge is usually never perfect because of maturity mismatches and principal amounts.

The Company uses swaps to convert its instruments, such as mortgages, deposits and liquid assets, from fixed or base rate-linked rates to reference linked variable rates. This ensures a guaranteed margin between the interest income and interest expense, regardless of changes in the market rates.

Types of risk

The principal financial risks to which the Company is exposed are credit, liquidity and market risks, the latter comprising interest rate risk. In addition to financial risks, the Company is exposed to various other risks, most notably operational risk, conduct risk and regulatory and compliance risk, which are covered in the Principal risks and uncertainties section on pages 8 to 18.

35. Risk management (continued)

Credit risk

Credit risk is the risk that losses may arise as a result of the Company's borrowers or market counterparties failing to meet their obligations to repay.

The Group has adopted the Standardised Approach for assessment of credit risk regulatory capital requirements. This approach considers risk weightings as defined under Basel II and Basel III principles.

The classes of financial instruments to which the Group is most exposed are loans and advances to customers, loans and advances to credit institutions, cash in the BoE call account, call and current accounts with other credit institutions and investment securities. The maximum credit risk exposure equals the total carrying amount of the above categories plus off-balance sheet undrawn committed mortgage facilities.

The change, during the period and cumulatively, in the fair value of investments in debt securities and loans and advances to customers at FVOCI and FVTPL that is attributable to changes in credit risk is not material.

Credit risk – loans and advances to customers

Credit risk associated with mortgage lending is largely driven by the housing market and level of unemployment. A recession and/or high interest rates could cause pressure within the market, resulting in rising levels of arrears and repossessions.

All loan applications are assessed with reference to the Company's Lending Policy. Changes to the policy are approved by the Group Risk Committee, with mandates set for the approval of loan applications.

The Group Credit Committee and ALCO regularly monitor lending activity, taking appropriate actions to reprice products and adjust lending criteria in order to control risk and manage exposure. Where necessary and appropriate, changes to the Lending Policy are recommended to the Group Risk Committee.

The following table shows the Company's maximum exposure to credit risk and the impact of collateral held as security, capped at the gross exposure amount, by impairment stage. Capped collateral excludes the impact of forced sale discounts and costs to sell. The collateral value is determined by indexing against monthly House Price Index data.

	2022		2021	
	Gross carrying amount £m	**Capped collateral held £m**	Gross carrying amount £m	Capped collateral held £m
Stage 1	**7,897.1**	**7,896.4**	7,401.3	7,401.3
Stage 2[1]	**2,203.6**	**2,203.4**	1,265.7	1,265.7
Stage 3	**170.9**	**170.9**	121.2	121.2
Stage 3 (POCI)	**1.0**	**1.0**	1.3	1.3
	10,272.6	**10,271.7**	8,789.5	8,789.5

1. The increase in balance of accounts in Stage 2 is due to the increased credit risk from heightened cost of living and cost of borrowing. For further detail relating to movements by stage see the risk review section on pages 8 to 18.

35. Risk management (continued)

Analysis of loans by Loan to Value

The Company uses indexed loan to value (LTV) ratios to assess the quality of the uncapped collateral held. Property values are updated to reflect changes in the HPI. A breakdown of loans and advances to customers by indexed LTV is as follows:

	2022					
	Buy-to-Let £m	**Residential £m**	**Bridging £m**	**Second charge lending £m**	**Total £m**	**%**
Band						
0% - 50%	**327.3**	**488.7**	**70.8**	**44.5**	**931.3**	**9**
50% - 60%	**866.3**	**452.4**	**28.4**	**30.6**	**1,377.7**	**13**
60% - 70%	**2,591.2**	**864.0**	**25.1**	**23.1**	**3,503.4**	**34**
70% - 80%	**3,535.9**	**594.7**	**23.5**	**13.3**	**4,167.4**	**41**
80% - 90%	**154.2**	**135.2**	**0.9**	**0.5**	**290.8**	**3**
90% - 100%	**0.2**	**0.8**	**-**	**-**	**1.0**	**-**
>100%	**-**	**-**	**1.0**	**-**	**1.0**	**-**
Total loans before provisions	**7,475.1**	**2,535.8**	**149.7**	**112.0**	**10,272.6**	**100**

	2021					
	Buy-to-Let £m	Residential £m	Bridging £m	Second charge lending £m	Total £m	%
Band						
0% - 50%	103.5	233.7	30.2	31.9	399.3	5
50% - 60%	202.4	222.8	9.3	28.3	462.8	5
60% - 70%	691.3	433.8	14.9	43.7	1,183.7	13
70% - 80%	4,768.5	1,139.4	1.4	35.8	5,945.1	68
80% - 90%	547.1	235.7	0.5	13.9	797.2	9
90% - 100%	0.1	1.3	-	-	1.4	-
Total loans before provisions	6,312.9	2,266.7	56.3	153.6	8,789.5	100

35. Risk management (continued)

Forbearance measures undertaken

The Company has a range of options available where borrowers experience financial difficulties which impact their ability to service their financial commitments under the loan agreement. These are explained in the Principal risks and uncertainties section on pages 8 to 18.

A summary of the forbearance measures undertaken (excluding COVID-19 related payment deferrals) during the year, is shown below. The balances disclosed reflect the yearend balance of the accounts where a forbearance measure was undertaken during the year.

Forbearance type	**Number of accounts 2022**	**At 31 December 2022 £m**	Number of accounts 2021	At 31 December 2021 £m
Interest-only switch	**22**	**2.2**	26	3.3
Interest rate reduction	**5**	**0.5**	-	-
Term extension	**51**	**2.9**	189	5.6
Payment holiday	**86**	**12.4**	132	17.1
Payment concession (reduced monthly payments)	**25**	**4.1**	7	1.0
Full or partial debt forgiveness	**3**	**0.1**	1	-
Total	**192**	**22.2**	355	27.0
Loan type				
First charge owner-occupier	**97**	**13.3**	125	15.6
Second charge owner-occupier[1]	**8**	**0.4**	17	0.7
Buy-to-Let	**35**	**5.6**	24	5.1
Bridging	**52**	**2.9**	189	5.6
Total	**192**	**22.2**	355	27.0

1. Through 2021 and the first quarter of 2022, the Group undertook an exercise and provided a series of forbearance solutions and options to long-term arrears customers on our Second charge portfolio to support and remedy the accrued delinquency.

35. Risk management (continued)

Geographical analysis by region

An analysis of gross loans by region is provided below:

	2022		2021	
Region	**£m**	**%**	£m	%
East Anglia	**1,109.6**	**11**	928.1	11
East Midlands	**675.8**	**7**	532.2	6
Greater London	**3,252.0**	**31**	2,985.9	34
North East	**268.2**	**3**	234.7	3
North West	**898.7**	**9**	723.4	8
Scotland	**255.2**	**2**	216.7	2
South East	**1,645.6**	**16**	1,396.4	16
South West	**644.2**	**6**	520.1	6
Wales	**275.6**	**3**	227.4	2
West Midlands	**744.8**	**7**	607.0	7
Yorks and Humberside	**502.9**	**5**	417.6	5
Total loans before provisions	**10,272.6**	**100**	8,789.5	100

35. Risk management (continued)

Approach to measurement of credit quality

The Company categorises the credit quality of loans and advances to customers into internal risk grades based on the 12 month PD calculated at the reporting date. The PDs include a combination of internal behavioural and credit bureau characteristics and are aligned with Capital models to generate the risk grades which are then further grouped into the following credit quality segments:

- Excellent quality – where there is a very high likelihood the asset will be recovered in full with a negligible or very low risk of default.
- Good quality – where there is a high likelihood the asset will be recovered in full with a low risk of default.
- Satisfactory quality – where the assets demonstrate a moderate default risk.
- Lower quality – where the assets require closer monitoring and the risk of default is of greater concern.

The following tables disclose the credit risk quality ratings of loans and advances to customers by IFRS 9 stage. The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period for the life of the loan. Loans and advances to customers initially booked on very low PDs and graded as excellent quality loans can experience a SICR and therefore be moved to Stage 2. Such loans may still be graded as excellent quality, if they meet the overall criteria.

During 2022, the Company developed Capital models as part of the IRB programme. As a result, the disclosures provided below are now aligned to internal Capital models and Rating systems. The 2021 figures have been updated to reflect the revised alignment with Capital models result, which compared to 2021 figures remain largely aligned with minor movements across segments.

2022	Stage 1 £m	Stage 2 £m	Stage 3 £m	Stage 3 (POCI) £m	Total £m	PD lower range %	PD upper range %
Loans and advances to customers							
Excellent	**5,538.9**	**1,092.8**	**-**	**-**	**6,631.7**	**-**	**0.3**
Good	**2,208.4**	**765.6**	**-**	**-**	**2,974.0**	**0.3**	**2.0**
Satisfactory	**124.8**	**159.2**	**-**	**-**	**284.0**	**2.0**	**7.4**
Lower	**25.0**	**186.0**	**-**	**-**	**211.0**	**7.4**	**100.0**
Impaired	**-**	**-**	**170.9**	**-**	**170.9**	**100.0**	**100.0**
POCI	**-**	**-**	**-**	**1.0**	**1.0**	**100.0**	**100.0**
	7,897.1	**2,203.6**	**170.9**	**1.0**	**10,272.6**		

2021							
Excellent	4,941.3	468.5	-	-	5,409.8	-	0.3
Good	2,355.6	464.8	-	-	2,820.4	0.3	2.0
Satisfactory	88.1	167.6	-	-	255.7	2.0	7.4
Lower	16.3	164.8	-	-	181.1	7.4	100.0
Impaired	-	-	121.2	-	121.2	100.0	100.0
POCI	-	-	-	1.3	1.3	100.0	100.0
	7,401.3	1,265.7	121.2	1.3	8,789.5		

35. Risk management (continued)

The tables below show the Company's other financial assets by credit risk rating grade: The credit grade is based on the external credit rating of the counterparty; AAA to AA- are rated Excellent; A+ to A- are rated Good; and BBB+ to BBB- are rated Satisfactory.

2022	Excellent £m	Good £m	Total £m
Investment securities	**202.3**	**-**	**202.3**
Loans and advances to credit institutions	**1,503.6**	**128.4**	**1,632.0**
Derivative assets	**217.0**	**230.2**	**447.2**
	1,922.9	**358.6**	**2,281.5**

2021	Excellent £m	Good £m	Total £m
Investment securities	477.8	-	477.8
Loans and advances to credit institutions	1,269.1	-	1,269.1
Derivative assets	7.8	79.1	86.9
	1,754.7	79.1	1,833.8

Credit risk – loans and advances to credit institutions and investment securities

The Company holds UK treasury instruments in order to meet liquidity requirements and for general business purposes. The credit risk arising from these investments is closely monitored and managed by the Group's Treasury function. In managing these assets, Group Treasury operates within guidelines laid down in the Group Market and Liquidity Risk Policy approved by ALCO and performance is monitored and reported to ALCO monthly, including through the use of an internally developed rating model based on counterparty credit default swap spreads.

The Company has limited exposure to non-investment grade debt. ALCO is responsible for approving treasury counterparties.

During the year, the average balance of loans and advances to credit institutions and investment securities on a monthly basis was £1,749.6m (2021: £1,467.5m).

The tables below show the industry sector of the Company's loans and advances to credit institutions and investment securities:

	2022		2021	
	£m	%	£m	%
BoE[1]	**1,503.3**	**82**	1,205.9	69
Other banks	**128.7**	**7**	63.2	4
Central government	**-**	**-**	252.0	14
Securitisation	**202.3**	**11**	225.8	13
Total	**1,834.3**	**100**	1,746.9	100

1. Balances with the BoE include £25.0m (2021: £23.0m) held in the cash ratio deposit.

For further information on Credit risk please refer to pages 8 to 18.

35. Risk management (continued)

Liquidity risk

Liquidity risk is the risk of having insufficient liquid assets to fulfil obligations as they become due or the cost of raising liquid funds becoming too expensive.

The Company's approach to managing liquidity risk is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding in order to retain full public confidence in the solvency of the Company and to enable the Company to meet its financial obligations as they fall due. This is achieved through maintaining a prudent level of liquid assets and control of the growth of the business. The Company has established call accounts with the BoE and has access to its contingent liquidity facilities.

Liquidity management is the responsibility of ALCO, with day-to-day management delegated to Treasury as detailed in the Treasury Policy. ALCO is responsible for setting risk appetite limits over the level and maturity profile of funding and for monitoring the composition of the Company financial position.

The Company also monitors a range of triggers, defined in the recovery plan, which are designed to capture liquidity stresses in advance in order to allow sufficient time for management action to take effect. These are monitored daily by the Risk team, with breaches immediately reported to the Group Chief Risk Officer, Chief Executive Officer, Chief Financial Officer and the Group Treasurer.

The tables below show the maturity profile for the Company's financial assets and liabilities based on contractual maturities at the reporting date:

2022	Carrying amount £m	On demand £m	Less than 3 months £m	3 - 12 months £m	1 - 5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	**8,623.1**	**1,451.6**	**1,676.5**	**4,111.6**	**1,383.4**	**-**
Amounts owed to credit institutions	**2,524.3**	**-**	**18.0**	**310.0**	**1,824.0**	**372.3**
Amounts owed to other customers	**112.6**	**-**	**29.2**	**76.5**	**6.9**	**-**
Derivative liabilities	**42.8**	**-**	**3.4**	**22.3**	**14.0**	**3.1**
Lease liabilities	**5.2**	**-**	**0.2**	**0.6**	**3.9**	**0.5**
Total liabilities	**11,308.0**	**1,451.6**	**1,727.3**	**4,521.0**	**3,232.2**	**375.9**
Financial asset by type						
Loans and advances to credit institutions	**1,632.0**	**1,476.0**	**3.5**	**-**	**-**	**152.5**
Investment securities	**202.3**	**-**	**4.9**	**12.2**	**185.2**	**-**
Loans and advances to customers	**10,260.9**	**39.7**	**43.4**	**184.0**	**349.3**	**9,644.5**
Derivative assets	**447.2**	**-**	**1.9**	**33.0**	**411.1**	**1.2**
Total assets	**12,542.4**	**1,515.7**	**53.7**	**229.2**	**945.6**	**9,798.2**
Cumulative liquidity gap		**64.1**	**(1,609.5)**	**(5,901.3)**	**(8,187.9)**	**1,234.4**

35. Risk management (continued)

2021	Carrying amount £m	On demand £m	Less than 3 months £m	3 - 12 months £m	1 - 5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	7,785.4	1,847.0	988.3	3,568.4	1,381.7	-
Amounts owed to credit institutions	1,900.8	2.5	1.0	-	1,824.0	73.3
Amounts owed to other customers	86.8	14.8	7.6	39.7	24.7	-
Derivative liabilities	11.3	-	0.4	5.8	5.1	-
Lease liabilities	5.6	-	0.3	0.6	3.4	1.3
Total liabilities	9,789.9	1,864.3	997.6	3,614.5	3,238.9	74.6
Financial asset by type						
Loans and advances to credit institutions	1,269.1	1,185.4	6.5	-	-	77.2
Investment securities	477.8	-	172.7	6.1	299.0	-
Loans and advances to customers	8,789.3	26.0	31.1	102.7	399.9	8,229.6
Derivative assets	86.9	-	0.1	3.5	83.2	0.1
Total assets	10,623.1	1,211.4	210.4	112.3	782.1	8,306.9
Cumulative liquidity gap		(652.9)	(1,440.1)	(4,942.3)	(7,399.1)	833.2

35. Risk management (continued)

Liquidity risk – undiscounted contractual cash flows

The following tables provide an analysis of the Company's gross contractual undiscounted cash flows, derived using interest rates and contractual maturities at the reporting date and excluding impacts of early payments or non-payments:

2022	Carrying amount £m	Gross inflow / outflow £m	Up to 3 months £m	3 - 12 months £m	1 - 5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	8,623.1	8,756.0	3,134.1	4,197.9	1,424.0	-
Amounts owed to credit institutions	2,524.3	2,708.7	36.7	359.9	1,939.8	372.3
Amounts owed to other customers	112.6	112.6	29.2	76.5	6.9	-
Derivative liabilities	42.8	36.6	12.3	8.6	15.7	-
Lease liabilities	5.2	6.4	0.2	0.8	4.9	0.5
Total liabilities	11,308.0	11,620.3	3,212.5	4,643.7	3,391.3	372.8
Off-balance sheet loan commitments	455.1	455.1	455.1	-	-	-
Financial asset by type						
Loans and advances to credit institutions	1,632.0	1,632.0	1,479.5	-	-	152.5
Investment securities	202.3	224.1	7.1	18.5	198.5	-
Loans and advances to customers	10,260.9	26,194.7	152.4	559.9	3,134.8	22,347.6
Derivative assets	447.2	349.6	49.4	106.1	194.1	-
Total assets	12,542.4	28,400.4	1,688.4	684.5	3,527.4	22,500.1

35. Risk management (continued)

2021	Carrying amount £m	Gross inflow / outflow £m	Up to 3 months £m	3 - 12 months £m	1 - 5 years £m	More than 5 years £m
Financial liability by type						
Amounts owed to retail depositors	7,785.4	7,832.7	2,837.5	3,594.4	1,400.8	-
Amounts owed to credit institutions	1,900.8	1,916.5	1.9	3.4	1,837.9	73.3
Amounts owed to other customers	86.8	86.9	22.4	39.8	24.7	-
Derivative liabilities	11.3	(4.0)	(0.8)	(0.5)	(2.7)	-
Lease liabilities	5.6	7.3	0.3	0.9	4.5	1.6
Total liabilities	9,789.9	9,839.4	2,861.3	3,638.0	3,265.2	74.9
Off-balance sheet loan commitments	434.5	434.5	434.5	-	-	-
Financial asset by type						
Loans and advances to credit institutions	1,269.1	1,269.1	1,185.4	6.5	-	77.2
Investment securities	477.8	482.4	171.9	107.7	202.8	-
Loans and advances to customers	8,789.3	17,246.1	116.5	359.6	1,962.3	14,807.7
Derivative assets	86.9	(23.1)	(1.1)	(4.1)	(17.9)	-
Total assets	10,623.1	18,974.5	1,472.7	469.7	2,147.2	14,884.9

The actual repayment profile of retail deposits may differ from the analysis above due to the option of early withdrawal with a penalty.

The actual repayment profile of loans and advances to customers may differ from the analysis above since many mortgage loans are repaid prior to the contractual end date.

35. Risk management (continued)

Liquidity risk – assets encumbered

Asset encumbrance levels are monitored by ALCO. The following tables provide an analysis of the Company's encumbered and unencumbered assets:

	2022				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Loans and advances to credit institutions	**127.8**	**25.0**	**1,478.3**	**0.9**	**1,632.0**
Investment securities	**11.6**	**-**	**190.7**	**-**	**202.3**
Loans and advances to customers	**3,144.5**	**-**	**7,116.4**	**-**	**10,260.9**
Derivative assets	**-**	**-**	**-**	**447.2**	**447.2**
Non-financial assets	**-**	**-**	**-**	**(356.4)**	**(356.4)**
	3,283.9	**25.0**	**8,785.4**	**91.7**	**12,186.0**

	2021				
	Encumbered		Unencumbered		
	Pledged as collateral £m	Other[1] £m	Available as collateral £m	Other[2] £m	Total £m
Loans and advances to credit institutions	63.2	23.0	1,182.9	-	1,269.1
Investment securities	121.8	-	356.0	-	477.8
Loans and advances to customers	2,496.7	-	6,292.6	-	8,789.3
Derivative assets	-	-	-	86.9	86.9
Non-financial assets	-	-	-	(51.2)	(51.2)
	2,681.7	23.0	7,831.5	35.7	10,571.9

1. Represents assets that are not pledged but that the Company believes it is restricted from using to secure funding for legal or other reasons
2. Represents assets that are not eligible for use as collateral.

35. Risk management (continued)

Liquidity risk – liquidity reserves

The tables below analyse the Company's liquidity reserves, where carrying value is considered to be equal to fair value:

	2022	2021
	£m	£m
Unencumbered balances with central banks	**1,478.3**	1,182.9
Unencumbered cash and balances with other banks	**0.9**	-
Unencumbered investment securities	**190.7**	356.0
	1,669.9	1,538.9

Market risk

Market risk is the risk of an adverse change in the Company's income or the Company's net worth arising from movement in interest rates, exchange rates or other market prices. The Company recognises that the effective management of market risk is essential to the maintenance of stable earnings.

Interest rate risk

The primary market risk faced by the Company is interest rate risk. Interest rate risk is the risk of loss from adverse movement in the overall level of interest rates. It arises from mismatches in the timing of repricing of assets and liabilities, both on and off-balance sheet. The Company does not run a trading book or take speculative interest rate positions and therefore all interest rate risk resides in the banking book (interest rate risk in the banking book (IRRBB)). IRRBB is most prevalent in mortgage lending and in fixed rate retail deposits. Exposure is mitigated on a continuous basis through the use of natural offsets between mortgages and savings with a similar tenor, interest rate derivatives and reserve allocations.

Interest rate risk is managed by applying an economic value at risk approach as well as an earnings at risk approach for interest rate risk and basis risk. The interest rate sensitivity is impacted by behavioural assumptions used by the Company; the most significant of which are prepayments and pipeline take up. Expected prepayments are monitored and modelled on a regular basis based upon historical analysis. The reserve allocation strategy is approved by ALCO and set to reflect the current balance sheet and future plans.

Economic value at risk is measured using the impact of six different internally derived interest rate scenarios. The internal scenarios are defined by ALCO and are based on three 'shapes' of curve movement (shift, twist and flex). Historical data is used to calibrate the severity of the scenarios to the Company's risk appetite. The Board has set limits on interest rate risk exposure of 2.25% and 1% of CET1 for the Company. The maximum decrease to net interest income under these scenarios after taking into account the derivatives is £1.9m (2021: £(1.2)m).

Exposure for earnings at risk is measured by the impact of a +/-100 basis points (bps) parallel shift in interest rates on the expected profitability of the Company in the next 12 months. The risk appetite limit is 4% of full year net interest income. The maximum decrease after taking into account the derivatives is £8.2m (2021: £0.4m, impact of a +/-50bps parallel shift was reported against a limit of 2% of full year NII).

35. Risk management (continued)

The Company is also exposed to basis risk. Basis risk is the risk of loss from an adverse divergence in interest rates. It arises where assets and liabilities reprice from different variable rate indices. These indices may be market rates (e.g. bank base rate or SONIA) or administered (e.g. the Company's standard variable rate (SVR), other discretionary variable rates, or that received on call accounts with other banks).

The Company measures basis risk using the impact of four scenarios on net interest income over a one-year period including movements such as diverging base, overnight and term SONIA rates. Historical data is used to calibrate the severity of the scenarios to the Group's risk appetite. The Board has set a limit on basis risk exposure of 2.5% of full year net interest income. The maximum decrease to net interest income is £4.3m (2021: £(3.7)m).

Unconsolidated structured entities

There were no unconsolidated structured entities which were sponsored by the Company during the current or prior year.

36. Financial instruments and fair values

I. Financial assets and financial liabilities

The table below sets out the classification of financial instruments in the Statement of Financial Position.

		2022				
	Note	Designated FVTPL £m	Mandatorily FVTPL £m	FVOCI £m	Amortised cost £m	Total carrying amount £m
Financial assets						
Loans and advances to credit institutions	14	-	-	-	1,632.0	1,632.0
Investment securities	15	-	-	0.7	201.6	202.3
Loans and advances to customers	16	14.6	-	735.7	9,510.6	10,260.9
Derivative assets	19	-	447.2	-	-	447.2
Other assets[1]	21	-	-	-	2.1	2.1
		14.6	447.2	736.4	11,346.3	12,544.5
Financial liabilities						
Amounts owed to retail depositors	25	-	-	-	8,623.1	8,623.1
Amounts owed to credit institutions	24	-	-	-	2,524.3	2,524.3
Amounts owed to other customers	26	-	-	-	112.6	112.6
Derivative liabilities	19	-	42.8	-	-	42.8
Other liabilities	28	-		-	4.6	4.6
		-	42.8	-	11,264.6	11,307.4

1. Balance excludes prepayments.

36. Financial instruments and fair values (continued)

		2021				
	Note	**Designated FVTPL £m**	**Mandatorily FVTPL £m**	**FVOCI £m**	**Amortised cost £m**	**Total carrying amount £m**
Financial assets						
Loans and advances to credit institutions	14	-	-	-	1,269.1	1,269.1
Investment securities	15	-	-	154.7	323.1	477.8
Loans and advances to customers	16	17.7	-	945.6	7,826.0	8,789.3
Derivative assets	19	-	86.9	-	-	86.9
Other assets[1]	21	-		-	3.0	3.0
		17.7	86.9	1,100.3	9,421.2	10,626.1
Financial liabilities						
Amounts owed to retail depositors	25	-	-	-	7,785.4	7,785.4
Amounts owed to credit institutions	24	-	-	-	1,900.8	1,900.8
Amounts owed to other customers	26	-	-	-	86.8	86.8
Derivative liabilities	19	-	11.3	-	-	11.3
Other liabilities	28	-		-	5.5	5.5
		-	11.3	-	9,778.5	9,789.8

1. Balance excludes prepayments.

The Group has no non-derivative financial assets or financial liabilities classified as held for trading.

36. Financial instruments and fair values (continued)

II. Fair values

The following tables summarise the carrying value and estimated fair value of financial instruments not measured at fair value in the Statement of Financial Position:

	2022		2021	
	Carrying value £m	**Estimated fair value £m**	Carrying value £m	Estimated fair value £m
Financial assets				
Loans and advances to credit institutions	**1,632.0**	**1,632.0**	1,269.1	1,269.1
Investment securities	**201.6**	**199.6**	323.1	323.8
Loans and advances to customers	**9,510.6**	**9,160.8**	7,826.0	7,986.2
Other assets[1]	**2.1**	**2.1**	3.0	3.0
	11,346.3	**10,994.5**	9,421.2	9,582.1
Financial liabilities				
Amounts owed to retail depositors	**8,623.1**	**8,597.1**	7,785.4	7,787.6
Amounts owed to credit institutions	**2,524.3**	**2,524.3**	1,900.8	1,900.8
Amounts owed to other customers	**112.6**	**112.6**	86.8	86.8
Other liabilities	**4.6**	**4.6**	5.5	5.5
	11,264.6	**11,238.6**	9,778.5	9,780.7

1. Balance excludes prepayments.

The fair values in these tables are estimated using the valuation techniques below. The estimated fair value is stated as at 31 December and may be significantly different from the amounts which will actually be paid on the maturity or settlement dates of each financial instrument.

Loans and advances to credit institutions

This represents the Company's call accounts with central governments and other banks, and also working capital current accounts, with an original maturity of less than three months. Fair value is not considered to be materially different to carrying value.

36. Financial instruments and fair values (continued)

Investment securities

Investment securities' fair values are provided by a third party and are based on the market values of similar financial instruments.

Loans and advances to customers

This mainly represents secured mortgage lending to customers. The fair value of mortgages has been estimated by discounting future cash flows at current market rates of interest. Future cash flows include the impact of ECL.

Other assets

Other assets disclosed in the table above exclude prepayments and the fair value is considered to be equal to carrying value.

Amounts owed to retail depositors

The fair value of fixed rate retail deposits has been estimated by discounting future cash flows at current market rates of interest. Retail deposits at variable rates and deposits payable on demand are considered to be at current market rates and as such fair value is estimated to be equal to carrying value.

Amounts owed to credit institutions

This mainly represents amounts drawn down under the BoE TFSME, ILTR and commercial repos. Fair value is considered to be equal to carrying value.

Amounts owed to other customers

This represents saving products to corporations and local authorities. The fair value of fixed rate deposits is estimated by discounting future cash flows at current market rates of interest. Deposits at variable rates are considered to be at current market rates and the fair value is estimated to be equal to carrying value.

Other liabilities

The fair value is considered to be equal to carrying value.

36. Financial instruments and fair values (continued)

III. Fair value classification

Financial instruments held at fair value

The following table provides an analysis of financial assets and financial liabilities measured at fair value in the Statement of Financial Position grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

2022	Carrying amount £m	Principal amount £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Investment securities	**0.7**	**0.7**	**-**	**0.7**	**-**	**0.7**
Loans and advances to customers held at FVOCI	**735.7**	**777.0**	**-**	**-**	**735.7**	**735.7**
Loans and advances to customers held at FVTPL	**14.6**	**17.7**	**-**	**-**	**14.6**	**14.6**
Derivative assets	**447.2**	**7,391.0**	**-**	**447.2**	**-**	**447.2**
	1,198.2	**8,186.4**	**-**	**447.9**	**750.3**	**1,198.2**
Financial liabilities						
Derivative liabilities	**42.8**	**4,360.0**	**-**	**42.8**	**-**	**42.8**

2021	Carrying amount £m	Principal amount £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Investment securities	154.7	150.0	-	154.7	-	154.7
Loans and advances to customers held at FVOCI	945.6	919.6	-	-	945.6	945.6
Loans and advances to customers held at FVTPL	17.7	19.7	-	-	17.7	17.7
Derivative assets	86.9	5,973.0	-	86.9	-	86.9
	1,204.9	7,062.3	-	241.6	963.3	1,204.9
Financial liabilities						
Derivative liabilities	11.3	3,962.0	-	11.3	-	11.3

36. Financial instruments and fair values (continued)

Level 1: Fair values that are based entirely on quoted market prices (unadjusted) in an actively traded market for identical assets and liabilities that the Company has the ability to access. Valuation adjustments and block discounts are not applied to Level 1 instruments. Since valuations are based on readily available observable market prices, this makes them most reliable, reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values.

Level 2: Fair values that are based on one or more quoted prices in markets that are not active or for which all significant inputs are taken from directly or indirectly observable market data. These include valuation models used to calculate the present value of expected future cash flows and may be employed either when no active market exists or when there are no quoted prices available for similar instruments in active markets.

Level 3: Fair values for which any one or more significant input is not based on observable market data and the unobservable inputs have a significant effect on the instrument's fair value. Valuation models that employ significant unobservable inputs require a higher degree of management judgement and estimation in determining the fair value. Management judgement and estimation are usually required for the selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instruments being valued, determination of the probability of counterparty default and prepayments, determination of expected volatilities and correlations and the selection of appropriate discount rates.

36. Financial instruments and fair values (continued)

IV. Fair values of financial instruments carried at amortised cost

The following tables provide an analysis of financial assets and financial liabilities not measured at fair value in the Statement of Financial Position grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

			Estimated fair value			
2022	**Carrying amount £m**	**Principal amount £m**	**Level 1 £m**	**Level 2 £m**	**Level 3 £m**	**Total £m**
Financial assets						
Loans and advances to credit institutions	**1,632.0**	**1,629.4**	**-**	**1,632.0**	**-**	**1,632.0**
Investment securities	**201.6**	**201.1**	**-**	**199.6**	**-**	**199.6**
Loans and advances to customers	**9,510.6**	**9,440.5**	**-**	**-**	**9,160.8**	**9,160.8**
Other assets[1]	**2.1**	**2.1**	**-**	**2.1**	**-**	**2.1**
	11,346.3	**11,273.1**	**-**	**1,833.7**	**9,160.8**	**10,994.5**
Financial liabilities						
Amounts owed to retail depositors	**8,623.1**	**8,568.2**	**-**	**2,724.0**	**5,873.1**	**8,597.1**
Amounts owed to credit institutions	**2,524.3**	**2,506.3**	**-**	**2,524.3**	**-**	**2,524.3**
Amounts owed to other customers	**112.6**	**111.6**	**-**	**-**	**112.6**	**112.6**
Other liabilities	**4.6**	**4.6**	**-**	**4.6**	**-**	**4.6**
	11,264.6	**11,190.7**	**-**	**5,252.9**	**5,985.7**	**11,238.6**

1. Balance excludes prepayments.

36. Financial instruments and fair values (continued)

2021	Carrying amount £m	Principal amount £m	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Financial assets						
Loans and advances to credit institutions	1,269.1	1,269.1	-	1,269.1	-	1,269.1
Investment securities	323.1	325.5	-	323.8	-	323.8
Loans and advances to customers	7,826.0	7,806.7	-	-	7,986.2	7,986.2
Other assets[1]	3.0	3.0	-	3.0	-	3.0
	9,421.2	9,404.3	-	1,595.9	7,986.2	9,582.1
Financial liabilities						
Amounts owed to retail depositors	7,785.4	7,762.5	-	3,083.6	4,704.0	7,787.6
Amounts owed to credit institutions	1,900.8	1,897.8	-	1,900.8	-	1,900.8
Amounts owed to other customers	86.8	86.8	-	-	86.8	86.8
Other liabilities	5.5	5.5	-	5.5	-	5.5
	9,778.5	9,752.6	-	4,989.9	4,790.8	9,780.7

1. Balance excludes prepayments.

37. Related party transactions

Transactions between the Company and its related parties are disclosed below.

	2022		2021	
Management services	**Charged by/(to) the Company during the year £m**	**Balance due to/(by) the Company £m**	Charged by/(to) the Company during the year £m	Balance due to/(by) the Company £m
OneSavings Bank plc	**(19.4)**	**0.7**	(8.9)	(1.0)
Exact Mortgage Experts Limited	**(30.1)**	**0.6**	(35.6)	2.0
Broadlands Finance Limited	**-**	**0.1**	-	-
Charter Mortgages Limited	**-**	**0.1**	-	-
Trading transactions				
Canterbury Finance 3 plc	**-**	**-**	-	2.6

All related party transactions are with other subsidiaries of OSBG. All transactions with other companies within the Group are considered to be at arm's length.

OSB and EME provide management services to the Company including the provision of employees, premises and systems. A fee is invoiced monthly in respect of these services, as shown above. Fees are paid in the month following the invoice being raised.

CCFSG provides holding company services to the Company and recharges any of its costs to its subsidiaries as they arise.

CML collects payments from the Company's portfolio of acquired mortgages, on behalf of the Company.

Capital transaction

During 2021 the Company issued £60.0m of AT1 Securities to OSBG. For further details see note 33.

Sale of residential mortgages

During the current and prior year, the Company sold no residential mortgages to fellow subsidiaries of the Group.

38. Adjustments for non-cash items and changes in operating assets and liabilities

	2022 £m	2021 £m (Restated)[1]
Adjustments for non-cash items:		
Depreciation and amortisation	**3.4**	3.3
Interest on investment securities	**(4.7)**	-
EIR adjustment	**3.0**	(3.1)
Interest on financing debt	**30.7**	1.8
Impairment charge/(credit) on loans	**8.6**	(8.1)
Fair value gains on financial instruments[1]	**(42.2)**	(11.9)
Interest on lease liabilities	**0.1**	0.2
Total adjustments for non-cash items[1]	**(1.1)**	(17.8)
Changes in operating assets and liabilities:		
(Increase)/decrease in loans and advances to credit institutions	**(66.6)**	36.2
Increase in loans and advances to customers[1]	**(1,495.6)**	(1,066.0)
Increase in amounts owed to retail depositors	**837.7**	890.7
Increase in cash collateral and margin received[1]	**303.0**	73.3
Net decrease/(increase) in other assets	**1.1**	(1.3)
Net increase in derivatives and hedged items[1]	**9.3**	16.3
Net increase in amounts owed to other customers	**24.0**	19.7
Net decrease in other liabilities	**(0.9)**	(5.6)
Total changes in operating assets and liabilities[1]	**(388.0)**	(36.7)

1. 2021 figures restated see note 1 b) for further details.

39. Ultimate parent undertaking

OSBG is the ultimate parent and controlling party preparing consolidated financial statements as the largest group of which the Company is a member. Copies of OSBG's financial statements may be obtained from the Company Secretary at the registered office: OSB House, Quayside, Chatham Maritime, Chatham, ME4 4QZ.

OSB is the parent company of the smallest group preparing consolidated financial statements of which the Company is a member. Copies of OSB's financial statements may be obtained from the Company Secretary at the registered office: Reliance House, Sun Pier, Chatham, Kent ME4 4ET.

40. Capital management

The Company manages its capital to ensure that it has sufficient capital resources to continue as a going concern and meet all regulatory requirements while optimising the return to stakeholders through the balance of its capital resources. The capital structure of the Group consists of debt, which includes the borrowings disclosed in the Group financial statements, cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings as disclosed in the Group financial statements.

The Company conducts an ICAAP, which is approved by the Board of Directors. The ICAAP is used to assess the Company's capital adequacy and determine the levels of capital required to support the current and future risks in the business derived from its five year corporate plan.

The Capital Requirements Directive IV introduced the concept of a leverage ratio requirement, a non-risk based measure that is designed to act as a supplement to risk based capital requirements. The UK Leverage Ratio Framework is applicable to firms with over £50bn of retail deposits.

The Company is supervised by the PRA who review the Capital adequacy, compliance with regulatory requirements and the ICAAP as part of its CSREP. The PRA issues total capital requirement which specifies the level of regulatory capital which the Company is required to hold relative to its risk weighted assets as well as a PRA designated capital buffer.

The Company's regulatory capital is reviewed on a regular basis by the Board of Directors and ALCO on both a current and forward looking basis. The future regulatory capital requirements are also considered as part of the Company's forecasting and strategic planning process.

41. Events after the reporting date

The Directors have proposed an interim dividend of £44.9m in relation to profits for the year ended 31 December 2022 and a special dividend of £20.0m as its contribution to the proposed OSBG dividends. There is no final dividend proposed.