
# annual report and accounts 2021

TSB Banking Group plc

This has been a transformational year for TSB.  We have delivered strong growth. Our customer service is improving and we are now a much simpler and more resilient bank

Robin Bulloch
Interim Chief Executive, TSB

# Contents

# Strategic report

## Summary results

### Summary consolidated balance sheet

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| Loans and advances to customers | **37,383.8** | 33,317.9 | 12.2 |
| Other assets | **9,305.0** | 9,088.8 | 2.4 |
| **Total assets** | **46,688.8** | 42,406.7 | 10.1 |
| | | | |
| Customer deposits | **35,951.9** | 34,375.3 | 4.6 |
| Other liabilities | **8,887.0** | 6,324.8 | 40.5 |
| Shareholder's equity | **1,849.9** | 1,706.6 | 8.4 |
| **Total equity and liabilities** | **46,688.8** | 42,406.7 | 10.1 |

### Summary consolidated statutory income statement

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| Net interest income | **868.9** | 786.4 | 10.5 |
| Other income | **116.1** | 142.4 | (18.5) |
| **Total income** | **985.0** | 928.8 | 6.1 |
| Operating expenses | **(827.4)** | (969.4) | (14.6) |
| Impairment | **(0.1)** | (164.0) | (99.9) |
| **Statutory profit/(loss) before taxation** | **157.5** | (204.6) | n/a |
| Taxation | **(27.3)** | 44.9 | (160.8) |
| **Statutory profit/(loss) for the year** | **130.2** | (159.7) | n/a |

### Management basis profit/(loss) before taxation

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| **Management profit/(loss) before taxation** | **182.6** | (96.9) | n/a |
| Restructuring costs and other one off items[(1)] | **(29.0)** | (90.6) | (68.0) |
| Collection and recovery conduct charges[(2)] | **(2.2)** | (55.0) | (96.0) |
| Migration related items[(3)] | **9.7** | 34.1 | (71.6) |
| Banking volatility[(4)] | **(3.6)** | 3.8 | (194.7) |
| **Statutory profit/(loss) before taxation** | **157.5** | (204.6) | n/a |

### Key performance indicators

| | | | |
|---|---|---|---|
| Customer advocacy – Net Promoter Score (NPS)[(5)] | **2** | (4) | 6 |
| Share of new personal bank account gross flow[(6)] | **4.6%** | 4.5% | 0.1pp |
| Mortgage gross new lending (£ million) | **9,160.4** | 6,096.6 | 3,063.8 |
| Loan to deposit ratio[(7)] | **104%** | 97% | 7pp |
| Common Equity Tier 1 Capital ratio (fully loaded) | **15.8%** | 14.8% | 1.0pp |
| Leverage ratio (fully loaded) | **3.6%** | 3.7% | (0.1)pp |
| Net interest margin[(8)] | **2.44%** | 2.47% | (3)bps |
| Asset quality ratio[(9)] | **0.00%** | 0.51% | (51)bps |

(1) Comprises of costs of branch closures and the reorganisation of head office functions of £26.5 million (2020: £89.1 million) included in operating expenses (as shown in note 14 on page 83) and £2.5 million of intangible asset write off and losses on disposals of properties (2020: £1.5 million) (included in in losses on derecognition of non-financial assets in the income statement on page 64).

(2) As more fully described in note 29 to the consolidated financial statements on page 110.

(3) Relates to items arising from the IT migration undertaken in 2018. Comprises of insurance recoveries of £10.3 million (2020: £17.5 million) and related income from Lloyds Banking Group of £nil (2020: £17.6 million) included in other operating income (as shown in note 13 on page 81) less additional post migration costs £0.6 million (2020: £1.0 million) included in operating expenses.

(4) Banking volatility reflects (losses)/gains on derivatives partially mitigated by the use of hedge accounting, where relevant criteria are met, and volatility associated with share schemes.

(5) NPS is based on the question "On a scale of 0-10, where 0 is not at all likely and 10 is extremely likely, how likely is it that you would recommend TSB to a friend or colleague?" NPS is the percentage of TSB customers who give a score of 9 or 10 after subtracting the percentage who give a score 0 to 6. Calculated as a 3 month rolling average.

(6) Source: CACI Current and Savings Account Market Database which includes current, packaged, youth, student and basic bank accounts, and new account openings excluding account upgrades. Calculated on a 12 month rolling average basis. Data presented on a 2 month lag.

(7) Loans and advances to customers divided by customer deposits. Amounts as presented on the consolidated balance sheet on page 63.

(8) Net interest income divided by average loans and advances to customers, gross of impairment allowance.

(9) Impairment charge on loans and advances to customers divided by average loans and advances to customers, gross of impairment allowance.

# Chairman's letter

## Introduction

Joining TSB – a bank with a long and proud heritage, as well as an established brand – was a great privilege for me.

On behalf of all my Board colleagues, I want to put on record our heartfelt thanks to Richard Meddings for his outstanding leadership over the past four years. Richard has left the business in very good shape. The bank has a well-defined strategy for growth, and an experienced and high-performing management team, led by Robin Bulloch, who are executing that strategy with vigour. I am particularly grateful to Richard for ensuring that the handover was smooth and orderly, and to the Board and TSB colleagues for the warm welcome they extended to me.

I would also like to thank Debbie Crosbie, who left TSB shortly after I joined to take up a Chief Executive role elsewhere. Everyone at TSB is grateful for the part Debbie played in the turnaround of the business and she leaves with our thanks and very best wishes for the future.

I'm delighted that Robin, who has over four decades of retail banking experience at the highest level, has agreed to lead the business until a permanent appointment is made. Robin has been at the heart of transforming the TSB customer experience and has driven the bank's customer proposition, distribution strategies and brand relaunch. His appointment has the full support of the TSB Board and our shareholder, Sabadell. The Board's priority has been to support Robin and his leadership team to maintain the momentum in delivering TSB's growth strategy, seeing out the excellent performance in 2021 and making a positive start in 2022.

## Money Confidence. For everyone. Every day.

Already, my time at TSB has given me strong confidence that the business will continue to grow and thrive. First and foremost, the Bank has a strong focus on its customers, guided by its purpose – Money Confidence. For everyone. Every day. This purpose is backed by talented and committed colleagues who demonstrate an excellent understanding of its role in delivering the bank's strategic goals.

The economic challenges currently facing the country and the financial sector are significant and the prospects for 2022 and beyond remain uncertain. There will also be continued speculation on consolidation across financial services and other sectors. However, TSB remains focused on its purpose and strategy and the huge opportunities we have to draw on our brand and reach across the country. Success will mean getting ever closer to customers, adapting and evolving to meet their needs, and empowering them to take control of how they manage their money.

## TSB's role in society at large

TSB is also focused on key emerging issues. From the impact of climate change, the diversity and inclusion agenda, the threat of digital poverty and the role of businesses in communities, TSB's responsible business strategy, the Do What Matters Plan, provides the framework for urgent and appropriate action. By aligning the plan with the business strategy, it allows the bank to grow the business and its social and environmental contribution in tandem.

## Conclusion

I would like to thank all TSB employees for the part they have played in turning the business around and delivering such a strong set of results.

The three-year strategy put in place in 2019 will reach term in the coming year. I look forward to working with the Board and with Robin and his team to develop the next phase of TSB's story, embedding our strategic progress and preparing the Bank for even greater success in the future.

TSB enters 2022 with confidence and optimism that it can make a meaningful contribution to millions of customers, the economy and wider society.

**Nick Prettejohn**
*Chairman, 26 January 2022*

# Chief Executive's statement

## Introduction
This has been a transformational year for TSB. We have delivered strong growth and progress and I'm grateful to all my colleagues in the bank for rising to every challenge the year presented.

While 2020 was defined by our response to the pandemic, 2021 was about getting back to growth and delivering our Money Confidence purpose. I am pleased to report that we have delivered an impressive improvement in financial performance and a management profit in every quarter of the year. Both lending and deposits have increased, costs have reduced, and capital and liquidity are strong and stable.

It has also been a pleasure to welcome TSB's new chairman, Nick Prettejohn, who has many years of experience in financial services. I am confident all of us at TSB will benefit greatly from the fresh perspectives he brings to the Board.

## A relentless focus on customer experience
Customer service is improving and we are a simpler, more efficient and more resilient bank. Our customers have more ways to engage with us than ever before and we've become more streamlined in how we support them with both modern digital services and reassuring personal support in branch or over the phone when life events demand it.

In 2021 we delivered:

- outstanding growth in mortgages, breaking all previous records for TSB, including helping more than 16,000 first-time buyers to get their foot on the first rung of the property ladder;
- the new Spend & Save Plus current account – with additional features to help our customers manage their money;
- partnerships that increase our customers' Money Confidence, including Wealthify and Freedom Finance; and
- 135 branch upgrades and over 40 new 'pop-up' services helping to transform customer service in our branch network.

The new Tech Hub in Edinburgh and our cloud-based architecture have provided a digital platform that delivers more convenient services to customers in a quick and cost-effective way. The enthusiasm of our colleagues to adopt a digital-first approach has meant that we can provide better services more flexibly, including new video consultations for mortgage customers and chatbot TSB Smart Agent in our mobile app. Together, these have contributed to improved Net Promoter Scores for banking on mobile in the second half of the year.

I continue to be impressed with how our colleagues embrace our purpose – Money Confidence. For everyone. Every day – and find new ways to support customers, particularly through the continuing challenge of the COVID-19 pandemic.

We know customers have greater expectations from businesses now, and they want the brands they deal with to share their values. Our responsible business strategy – the Do What Matters Plan – described on pages 21 to 29, ensures that we continue to grow sustainably and do the right thing by our customers, our colleagues and the communities we serve. For TSB, this means setting the gold standard for consumer protection through our industry-leading Fraud Refund Guarantee, paying suppliers promptly, ensuring we have more women in senior roles, working towards stretching diversity goals, and getting on with the vital work to achieve operational net zero by 2030.

# Chief Executive's statement (continued)

## Financial Summary

The continued strength of our business, combined with a focus on customers, digital engagement and operational excellence has contributed to a strong financial result this year.

TSB has reported a statutory profit before tax of £157.5 million, compared to a loss before tax of £204.6 million in 2020. The turnaround is underpinned by the improved economic outlook, execution of TSB's strategy and our response to COVID-19.

A highlight of these results is our continued balance sheet strength with a record £9.2 billion (2020: £6.1 billion) of gross mortgage lending supported by buoyant mortgage demand, driving a £4.1 billion or 12.2% increase in total lending balances. Our customer lending portfolios have remained resilient, and the economic outlook has continued to improve, leading to a reduction in credit impairment charges to £0.1 million (2020: £164.0 million) that will not be repeated in 2022. Deposit balances have also grown, with an increase of 4.6% to £36.0 billion. We have also continued to simplify TSB's business with operating expenses decreasing 3.7% to £797.4 million.

## Outlook and Strategy

Looking ahead, the economic environment remains difficult to predict. Uncertainty about the pace and strength of recovery into 2022 continues as consumer spending begins to level off and inflation impacts both household and business budgets.

The level of regulatory change across the industry remains elevated, bringing its own challenges, such as the new standards relating to consumer duty, ongoing evolution of capital regulations, and expectations for corporate reforms through Government consultations.

TSB's robust capital and liquidity position means we are well placed to navigate these headwinds. These results demonstrate that TSB is on track to deliver balance sheet growth, cost efficiency and profitability as set out in the 2019 growth strategy. In the face of the pandemic, the business has developed an operational resilience, tenacity and action-oriented customer focus that will make us even more competitive in 2022.

In conclusion, I want to thank my TSB colleagues for a job well done in 2021. We will continue our journey to meet more of our customers' financial needs with comprehensive digital services and products combined with a personal touch through our contact centres, branches and with new video consultations.

**Robin Bulloch**
*Interim Chief Executive*
*26 January 2022*

# Our purpose and business model

**Our purpose – Money Confidence. For everyone. Every day.**
TSB offers a range of retail banking services and products to individuals and small business banking customers in the UK. TSB has a multi-channel model, including full digital (internet and mobile), telephone and national branch banking service.

We believe that TSB's multi-channel offer creates an opportunity for TSB to serve customers better. They want a bank that gives them access to both skilled people and easy digital tools to meet their banking needs and this, in turn, improves their confidence in managing their money. TSB continues to invest in developing digital-led products and servicing capabilities that meet customers' needs now and into the future.

This is fully integrated into the way we serve with a human touch over the phone or in our network of branches across the whole of Great Britain and ensures we live up to our purpose of Money Confidence. For everyone. Every day.'

**Our business model is simple**
TSB's business model reflects a simple retail business and is outlined below:

| Component | Description | 2021 performance | Financial statements | Key performance indicator |
|---|---|---|---|---|
| Customer confidence | We seek to deliver a banking experience that is the primary reason for customers to choose and remain with TSB, and which will increasingly set TSB apart from other banks and providers of financial services.<br>Central to this is our purpose 'Money Confidence. For everyone. Every day.' which focuses investment in digital capabilities and customer-led service strategies. | n/a | n/a | **Customer advocacy (Net Promoter Score)**<br>**2021**: **2** / **2020**: (4)<br>**Total digitally active customers**<br>**2021**: **67.8%** / **2020**: 66.4% |
| Sources of funding and capital | Money deposited by customers into their personal current accounts (PCA) and savings accounts provides the majority of the funds we use to support lending to customers. We also raise funds from other sources, including wholesale markets and central banks, that diversify our funding profile. Our shareholder provides funding in the form of debt and equity capital. | Page 8 | Page 66 | **Share of personal bank account gross flow**<br>**2021**: **4.6%** / **2020**: 4.5%<br>**Share of PCA stock**<br>**2021**: **4.2%** / **2020**: 4.3% |
| Loans and liquid assets | Funds deposited with TSB are used to support lending to customers who wish to borrow. A portion of funds are held in reserve, in the form of a liquidity portfolio, to meet any unexpected funding requirements. | Page 10 | Page 70 | **Mortgages gross lending (£m)**<br>**2021**: **9,160.4** / **2020**: 6,096.6 |
| Income | We earn income in the form of interest that we receive on the loans we make to customers and from our liquidity portfolio. We pay interest to savings and bank account customers on the money they deposit with us. We also earn other income in the form of fees and charges for the provision of other banking services and commissions from the sale of certain products such as general insurance. | Page 11 | Page 80 | **Net interest margin**<br>**2021**: **2.44%** / **2020**: 2.47% |
| Charges | The costs of running the Bank include paying our TSB employees, running our branches, investing in our business (such as developing digital opportunities) and paying for marketing. Occasionally, our customers are unable to repay the money they borrow from us; this is also a cost to the Bank in the form of an impairment charge. Finally, TSB complies with its tax obligations to Her Majesty's Revenue and Customs (HMRC). | Page 12 | Page 82 | **Cost:income ratio (management basis)**<br>**2021**: **81.4%** / **2020**: 92.5%<br>**Asset quality ratio**<br>**2021**: **0.00%** / **2020**: 0.51% |

**Risk management (2021 performance on page 13; financial statements on page 87)**
Effective risk management underpins TSB's business model. The Board sets an appetite for risk and monitors the risks arising from delivery of TSB's strategy through its business model to ensure the Bank remains liquid, solvent, operationally stable, trusted and compliant. When appropriate, the Board, in turn, will determine whether to return any profits made by the Bank to the shareholder by way of dividend or to reinvest the profit to support the future growth of the Bank.

# Financial performance in 2021

TSB's performance is presented on a statutory basis and structured in a manner consistent with the key elements of the business model as explained on page 6.

**Profitability (statutory basis)**

| | Analysis | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|---|
| Net interest income | Page 11 | **868.9** | 786.4 | 10.5 |
| Other income | Page 11 | **116.1** | 142.4 | (18.5) |
| **Total income** | | **985.0** | 928.8 | 6.1 |
| **Operating expenses** | Page 12 | **(827.4)** | (969.4) | (14.6) |
| **Impairment** | Page 12 | **(0.1)** | (164.0) | (99.9) |
| **Statutory profit/(loss) before taxation** | | **157.5** | (204.6) | n/a |

TSB's statutory profit before tax for 2021 was £157.5 million compared to a loss before tax of £204.6 million in 2020. The key factors driving the notable year-on-year improvement were:

- *Income*: an increase in total income of 6.1% to £985.0 million (2020: £928.8 million), primarily reflecting growth in core mortgage balances in a buoyant housing market which was facilitated, in part, by lower stamp duty rates in the year and higher current account net other income from increased consumer spending. This was partially offset by lower interest-bearing credit card balances due to changes in consumer behaviour, lower gains on the sale of debt securities which reflects lower sales volumes, and lower migration related income from lower insurance recoveries and the prior period benefitting from dowry income from Lloyds Banking Group.

- *Operating expenses*: a reduction in operating expenses of 14.6% to £827.4 million (2020: £969.4 million). Management basis operating expenses reduced by 3.7% to £797.4 million (2020: £827.7 million) primarily reflecting lower staff and property costs and a return to a more normalised level of investment spend compared to 2020. On a statutory basis, operating expenses also reflect lower levels of restructuring charges compared with 2020 due to a reduction in branch closure activity, lower severance and transformation costs, and a significantly lower remediation charge relating to the treatment of some customers in arrears, following the recognition of a £55.0 million provision in 2020.

- *Impairment*: a significant reduction in credit impairment charges to £0.1 million (2020: £164.0 million), resulting from the improved economic outlook, including lower forecast unemployment and higher expected house prices.

**Profitability (management basis)**

Management basis profitability is presented to enable an assessment of TSB's underlying financial performance that excludes certain matters that are volatile and non-recurring in nature.

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| **Management profit/(loss) before taxation** | **182.6** | (96.9) | n/a |
| Restructuring costs and other one-off items | **(29.0)** | (90.6) | (68.0) |
| Collection and recovery conduct charges | **(2.2)** | (55.0) | (96.0) |
| Migration related items | **9.7** | 34.1 | (71.6) |
| Banking volatility | **(3.6)** | 3.8 | (194.7) |
| **Statutory profit/(loss) before taxation** | **157.5** | (204.6) | n/a |

TSB reported a management basis profit before tax in 2021 of £182.6 million (2020: £96.9 million loss) as a result of the reduction in credit impairment charges, increase in total income, and reduction in management basis operating expenses referred to above. The management basis profit before tax excludes:

- the costs of restructuring the Bank, reflecting a further phase of a restructuring programme in relation to branch closures and changes in certain head office support functions which has cost £168.2 million to date;

- the previously mentioned charges relating to the treatment of some customers in arrears, which was £2.2 million in 2021 (2020: £55.0 million) (see note 29 on page 110);

- the net effect of items relating to the IT systems migration in 2018, including related insurance receipts of £10.3 million (2020: £17.5 million) less additional post migration costs of £0.6 million (2020: £1.0 million). 2020 also benefitted from income from Lloyds Banking Group of £17.6 million which did not reoccur in 2021; and

- Banking volatility, which reflects losses/(gains) on derivatives, partially mitigated by the use of hedge accounting where relevant criteria are met, and volatility associated with share schemes.

Further information on the drivers of TSB's Income Statement performance is set out on pages 11 to 12.

# Financial performance in 2021 (continued)

## Sources of funding and capital

**Money deposited by customers into their bank and savings accounts provides the majority of the funds we use to support lending to customers. We also raise funds from other sources, including wholesale funding markets and equity invested by the shareholder.**

| | Further information | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|---|
| Customer deposits | Note 1 on page 66 | **35,951.9** | 34,375.3 | 4.6 |
| Non-customer funding: | | | | |
| Borrowings from the Bank of England | Note 2 on page 67 | **5,501.6** | 3,065.8 | 79.5 |
| Debt securities in issue | Note 2 on page 66 | **2,199.1** | 1,699.2 | 29.4 |
| Subordinated liabilities | Note 3 on page 68 | **291.8** | 391.3 | (25.4) |
| Total non-customer funding | | **7,992.5** | 5,156.3 | 55.0 |
| **Funding resources** | | **43,944.4** | 39,531.6 | 11.2 |
| **Shareholder's equity** | Note 22 on page 106 | **1,849.9** | 1,706.6 | 8.4 |
| **Total sources of funding** | | **45,794.3** | 41,238.2 | 11.0 |

### Sources of funding

*Customer deposits*
Customer deposits increased by £1.6 billion, or 4.6%, to £36.0 billion, reflecting a slower rate of growth compared to 2020 as levels of customer spending increased following an easing of COVID-19 lockdown restrictions.

Retail customer deposits grew by £1.3 billion to £33.2 billion, particularly in current account balances. Business banking customer deposit balances also saw growth with an increase of £0.3 billion, or 12.3%, to £2.8 billion. This was due to the flow of customers from the Incentivised Switching Scheme and business customers continuing to maintain higher levels of liquidity, supported by funds received through the Bounce Back Loan Scheme.

*Non-customer funding*
Non-customer funding increased by £2.8 billion to £8.0 billion, largely reflecting the £5.5 billion drawn under the Bank of England's Term Funding Scheme with additional incentives for SMEs (TFSME), partly offset by cumulative repayments of £3.1 billion of borrowings under the Bank of England's previous Term Funding Scheme (TFS). Debt securities in issue increased to £2.2 billion, following the issuance of £500 million of covered bonds in June 2021 which have traded successfully in the secondary market since issuance.

### Capital resources

TSB's capital position has remained above regulatory minimum requirements and internal risk appetite thresholds, with a Common Equity Tier 1 (CET1) capital ratio of 15.8% (2020: 14.8%) and a leverage ratio of 3.6% (2020: 3.7%) on a CRD IV fully loaded basis. In 2021, the increase in CET1 capital ratio reflected the increase in retained profit while credit risk-weighted assets remained largely stable.

| | At 31 Dec 2021 £ million | At 31 Dec 2020 £ million |
|---|---|---|
| Shareholder's equity per balance sheet | **1,849.9** | 1,706.6 |
| Deferred tax assets arising from carry forward losses | **(99.6)** | (102.7) |
| Cash flow reserve regulatory adjustment | **7.8** | 18.4 |
| Prudent valuation prudential filter adjustment | **(1.4)** | (2.3) |
| Intangible assets | **(44.1)** | (38.6) |
| **Common Equity Tier 1/Total Tier 1 capital (fully loaded)** | **1,712.6** | 1,581.4 |
| Tier 2 capital (fully loaded) | **305.9** | 432.8 |
| **Total capital resources (fully loaded)** | **2,018.5** | 2,014.2 |
| Risk-weighted assets (RWA) | **10,855.9** | 10,685.1 |
| Common Equity Tier 1/Total Tier 1 capital ratio (fully loaded) | **15.8%** | 14.8% |
| Total Capital ratio (fully loaded) | **18.6%** | 18.9% |

# Financial performance in 2021 (continued)

## Sources of funding and capital (continued)

The movements in regulatory capital in the year, as measured on a fully loaded basis, are shown below:

| | CET1/ Total Tier 1 £ million | Tier 2 £ million | Total capital resources £ million |
|---|---|---|---|
| **At 31 December 2020** | **1,581.4** | **432.8** | **2,014.2** |
| Profit attributable to the shareholder | **130.2** | **-** | **130.2** |
| Change in excess of provision over expected losses | **–** | **(42.0)** | **(42.0)** |
| Movement in other comprehensive income | **13.1** | **–** | **13.1** |
| Change in intangible assets | **(5.5)** | **–** | **(5.5)** |
| Movement in Tier 2 subordinated liabilities | **–** | **(84.9)** | **(84.9)** |
| Movement in deferred tax assets on carried forward tax losses | **3.1** | **–** | **3.1** |
| Cash flow hedging reserve regulatory adjustment movement | **(10.7)** | **–** | **(10.7)** |
| Prudent valuation prudential filter adjustment change | **1.0** | **–** | **1.0** |
| **At 31 December 2021** | **1,712.6** | **305.9** | **2,018.5** |

### Risk-weighted assets (CRD IV)

Risk-weighted assets (RWAs) at 31 December 2021 increased by £170.8 million (1.6%), primarily reflecting an increase in secured retail balances.

| | At 31 Dec 2021 £ million | At 31 Dec 2020 £ million |
|---|---|---|
| **Risk type analysis of risk-weighted assets:** | | |
| Standardised approach | **1,249.8** | 1,284.6 |
| Internal Ratings Based (IRB) approach | **8,188.4** | 7,982.7 |
| **Total credit risk** | **9,438.2** | 9,267.3 |
| Operational risk | **1,400.0** | 1,400.4 |
| Counterparty risk | **17.7** | 17.4 |
| **Total risk-weighted assets** | **10,855.9** | 10,685.1 |

### Leverage ratio

The leverage ratio measure is defined as the ratio of Tier 1 capital to total exposure. This measure is intended to complement the risk-based capital requirements with a simple, non-risk based 'backstop' measure. TSB calculates its leverage ratio based on the exposure measure in the revised Basel III leverage ratio framework published in January 2014 and adopted in the Capital Requirements Regulation (CRR) and the CRR definition of Tier 1.

| | At 31 Dec 2021 £ million | At 31 Dec 2020 £ million |
|---|---|---|
| **Total Tier 1 Capital for leverage ratio (fully loaded)** | **1,712.6** | 1,581.4 |
| | | |
| **Exposures for leverage ratio** | | |
| Total statutory balance sheet assets | **46,688.8** | 42,406.7 |
| Less accounting value for derivatives | **(413.8)** | (338.2) |
| Exposure value for derivatives and securities financing transactions | **119.2** | (103.2) |
| Lending commitments | **1,050.9** | 978.7 |
| Regulatory adjustments to Tier 1 | **(137.7)** | (125.2) |
| Other regulatory adjustments | **104.6** | 115.2 |
| **Total exposures** | **47,412.0** | 42,934.0 |
| | | |
| **Leverage ratio** | **3.6%** | 3.7% |

The leverage ratio of 3.6% exceeds the Basel recommended 3%. Under the PRA's UK leverage framework (which excludes BoE reserves from the definition of leverage exposure and applies to banks with customer deposits in excess of £50 billion), TSB's ratio of 4.1% exceeds the PRA's expectation of 3.25%.

Following the introduction of IFRS 9, TSB and other UK banks are supervised under transitional rules which are due to expire after December 2024. Based on these, TSB's CET1 ratio was 15.9% (2020: 15.3%), total capital ratio was 18.7% (2020: 18.9%) and leverage ratio was 3.6% (2020: 3.8%). The effect of the transitional adjustment to own funds, capital requirement and leverage will be disclosed within the 'Key Metrics' table in TSB's Pillar III Large Subsidiary Disclosures.

# Financial performance in 2021 (continued)

## Loans and liquid assets

**Funds deposited with TSB are used to support lending to customers who wish to borrow. A portion of funds are held in reserve, in the form of a liquidity portfolio, to meet any unexpected funding requirements.**

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| Secured (retail)(1) | **34,861.3** | 30,787.7 | 13.2 |
| Unsecured | **1,845.7** | 1,821.8 | 1.3 |
| Business banking | **676.8** | 708.4 | (4.5) |
| **Total loans and advances to customers** | **37,383.8** | 33,317.9 | 12.2 |
| Balances at central banks(2) | **4,741.5** | 4,910.1 | (3.4) |
| Debt securities(3) | **3,185.7** | 2,620.6 | 21.6 |
| **Total liquid asset portfolio** | **7,927.2** | 7,530.7 | 5.3 |

(1) Includes Whistletree secured loans of £1,036.8 million (2020: £1,209.6 million).
(2) Combined with cash balances and demand deposits of £109.7 million (2020: £146.5 million) when shown on TSB's consolidated balance sheet.
(3) Of which £1,069.0 million (2020: £1,496.9 million) is accounted for at fair value through other comprehensive income and £2,116.7 million (2020: £1,123.7 million) which is accounted for at amortised cost.

### Loans and advances to customers

Loans to customers increased by £4.1 billion, or 12.2%, to £37.4 billion, driven by secured retail lending growth to £34.9 billion. This primarily reflected a strong trading performance in a buoyant market during 2021, supported by high customer demand for house moves and government initiatives such as the Stamp Duty Land Tax Waiver that ended in September 2021. This was partly offset by the expected reduction in the closed Whistletree portfolio.

### Liquid asset portfolio

TSB's liquidity portfolio comprises highly liquid assets, primarily cash reserves at the Bank of England (BoE), UK gilts, supranational bonds, development bank bonds, and covered bonds, which are available and accessible to meet potential cash outflows. The increase in the liquid asset portfolio during 2021 reflects a net increase of £2.4 billion in borrowings from the Bank of England's term funding schemes, the issuance of £0.5 billion of covered bonds, and an increase in customer deposits of £1.6 billion, partially offset by funds required to support the £4.1 billion increase in loans to customers.

A key regulatory measure of liquidity is the Liquidity Coverage Ratio (LCR). This is designed to measure the short-term resilience of TSB's liquidity risk profile and is regularly monitored and forecast alongside other cash flow and liquidity ratios. At 31 December 2021, the LCR was 194.5% (2020: 201.0%) against a PRA minimum regulatory requirement of 100%, with the decrease in 2021 reflecting the continued lending growth and the repayment of borrowings under the TFS, partially offset by the drawdown of borrowing under the TFSME.

### Encumbered assets

At 31 December 2021, £2,785.2 million (2020: £2,404.9 million) of assets were encumbered with counterparties other than central banks, primarily as collateral to support the issuance of debt securities (note 2 on page 66). A further £18,406.9 million of assets were positioned at central banks as collateral in support of drawings under the TFSME and for normal liquidity management purposes, including held as cash.

| | | | Assets not positioned at central banks | | | |
|---|---|---|---|---|---|---|
| | Assets encumbered with counterparties other than central banks £ million | Assets positioned at central banks (pre-positioned plus encumbered) £ million | Readily available for encumbrance £ million | Capable of being encumbered £ million | Unencumbered - cannot be used £ million | Total assets £million |
| Cash balances and other demand deposits | – | 4,741.5 | – | – | 109.7 | 4,851.2 |
| Financial assets at fair value through other comp. income | – | – | 1,069.0 | – | – | 1,069.0 |
| Financial assets at amortised cost: | | | | | | |
| Debt securities | 257.5(1) | – | 1,909.2 | – | – | 2,166.7 |
| Loans to central banks and credit institutions | 56.1(2) | 143.6 | – | – | – | 199.7 |
| Loans and advances to customers | 2,450.0(3) | 13,521.8 | – | 21,412.0 | – | 37,383.8 |
| Other advances | 21.6(1) | – | – | – | 59.1 | 80.7 |
| Remainder of assets | – | – | – | – | 937.7 | 937.7 |
| **Total – December 2021** | **2,785.2** | **18,406.9** | **2,978.2** | **21,412.0** | **1,106.5** | **46,688.8** |
| Total – December 2020 | 2,404.9 | 16,490.2 | 2,204.7 | 20.108.7 | 1,198.2 | 42,406.7 |

(1) Collateral placed with counterparties in respect of derivative financial liabilities.
(2) Cash held on deposit by the covered bond entity.
(3) Mortgage loans encumbered in support of external covered bond issuance.

# Financial performance in 2021 (continued)

## Income

**We earn income in the form of interest that we receive on the loans we make to customers and from our liquidity portfolio and we pay interest to savings and bank account customers on money that they deposit with us. We also earn other income in the form of fees and charges for the provision of banking services and commissions from the sale of certain products such as general insurance.**

### Net interest income

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| **Net interest income (management and statutory basis)** | **868.9** | 786.4 | 10.5 |
| | | | |
| Net interest margin (statutory basis) | **2.44%** | 2.47% | (3)bps |

Net interest income increased by 10.5% to £868.9 million. This was primarily due to strong growth in secured lending balances during 2021, partly offset by lower overdraft balances from changes in consumer behaviours. The increase in 2021 also reflects the waiving of interest in 2020 from customers who required the Bank's support in the light of the COVID-19 pandemic.

*Interest rates earned on loans*

In 2021, the average rate earned on TSB's loans reduced to 2.58% (2020: 2.76%). This arose from a faster pace of growth in lower margin secured lending, relative to unsecured lending, and reflects increasing competitive dynamics in the mortgage market in the fourth quarter. The average rate earned on mortgages during 2021 decreased to 2.14% (2020: 2.29%). Yields on unsecured lending also decreased with a reduction to 9.72% (2020: 10.06%).

*Cost of funding resources*

The cost of customer deposits decreased to 0.08% in 2021 (2020: 0.23%), reflecting the full year impact of the partial pass-through of the decrease in the Bank of England base rate to 0.10% from 0.75% in March 2020 and the maturity of higher cost fixed-term savings balances. This resulted in lower savings deposit interest costs of 0.13% (2020: 0.30%) and lower bank account interest costs of 0.01% (2020: 0.14%). Business banking interest costs also reduced to a lower 0.09% in 2021 (2020: 0.21%).

### Other income

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| **Management basis other income** | **111.1** | 108.4 | 2.5 |
| Migration related items[1] | **10.3** | 35.1 | (70.7) |
| One off items | **(2.5)** | (1.5) | (66.7) |
| Banking volatility | **(2.8)** | 0.4 | (800.0) |
| **Statutory other income** | **116.1** | 142.4 | (18.5) |

(1) Comprises of insurance recoveries of £10.3 million (2020: £17.5 million) and related income from Lloyds Banking Group of £nil (2020: £17.6 million) included in other operating income (as shown in note 13 on page 81).

On a management basis, other income increased by 2.5% to £111.1 million, reflecting higher levels of consumer spending following more muted levels in 2020 due to the COVID-19 pandemic which resulted in higher interchange income, international payments, foreign exchange and ATM reciprocity in 2021. This was partially offset by lower net gains on sales of debt securities.

On a statutory basis, other income decreased by 18.5% primarily due to lower migration related income. The prior period included £17.6 million of dowry income from Lloyds Banking Group. Excluding this, migration related income from insurance recoveries of post migration losses decreased to £10.3 million (2020: £17.5 million).

# Financial performance in 2021 (continued)

## Charges

**Charges we incur include the costs of paying TSB employees, running our branches, investing in our business and paying for advertising and marketing. Occasionally, our customers are unable to repay the money they borrow from us; this is also a cost to the Bank in the form of our impairment charge. Finally, TSB complies with its tax obligations to Her Majesty's Revenue and Customs (HMRC).**

### Operating expenses

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| TSB employee related costs | **310.1** | 324.7 | (4.5) |
| IT servicing and licence costs | **199.2** | 189.7 | 5.0 |
| Property costs | **84.6** | 95.6 | (11.5) |
| Operational contracts | **47.5** | 44.5 | 6.7 |
| Marketing costs | **35.0** | 42.0 | (16.7) |
| Regulatory and professional costs | **30.3** | 29.4 | 3.1 |
| Investment costs | **43.3** | 57.5 | (24.7) |
| Other | **47.3** | 44.3 | 6.8 |
| **Management basis operating expenses** | **797.3** | 827.7 | (3.7) |
| Costs of restructuring the Bank[(1)] | **26.5** | 89.1 | (70.3) |
| Collection and recovery conduct charges[(2)] | **2.2** | 55.0 | (96.0) |
| Migration related items | **0.6** | 1.0 | (40.0) |
| Banking volatility | **0.8** | (3.4) | n/a |
| **Statutory basis operating expenses** | **827.4** | 969.4 | (14.6) |

(1) Comprises the costs of branch closures and the reorganisation of head office functions of £26.5 million (2020: £89.1 million) included in operating expenses (as shown in note 14 on page 83.

(2) As more fully described in note 29 to the consolidated financial statements on page 110.

Management basis operating expenses decreased by 3.7% to £797.3 million, primarily reflecting ongoing progress on initiatives to improve the efficiency of the Bank, including the simplification of the Bank's organisational design and the branch transformation programme. Also supporting this reduction was a lower level of investment spend which was elevated in 2020 as TSB enhanced its digital capability in response to changing customer behaviours.

On a statutory basis, operating expenses decreased by 14.6%, with the above cost reductions further supported by lower restructuring costs and lower conduct charges (a £55.0 million provision was charged in 2020 for estimated charges relating to the treatment of some customers in arrears).

### Impairment charge

| | 2021 £ million | 2020 £ million | Change % |
|---|---|---|---|
| Secured (retail) | **(4.1)** | 10.5 | (139.0) |
| Unsecured | **1.5** | 147.8 | (99.0) |
| Business banking | **2.7** | 5.7 | (52.6) |
| **Total impairment charge** | **0.1** | 164.0 | (99.9) |
| **Asset quality ratio** | **0.00%** | 0.51% | (51)bps |

The impairment charge decreased by 99.9% to £0.1 million, largely as a result of an improved economic outlook, including lower forecast unemployment and higher expected house prices. A summary of the economic scenarios used for assessing expected credit losses and related scenario weightings is provided in note 8 on pages 74 to 76.

### Taxation

The tax charge of £27.3 million (2020: tax credit of £44.9 million) reflects an effective tax rate of 17.3% (2020: 21.9%) which is lower than the applied UK corporation tax rate in 2021 of 27% (which consists of the main rate of 19% and the banking surcharge of 8% applicable to taxable profits of banks in excess of £25 million). The difference between the effective and applied tax rates is primarily due to the £15.4 million increase in the value of deferred tax assets arising from the increase in the main corporation tax rate from 19% to 25% with effect from April 2023. A reconciliation of the tax charge to that which would have resulted from using the applied UK corporation tax rate is set out in note 16 to the consolidated financial statements on page 85.

The impact of the subsequent reduction in the banking surcharge from 8% to 3% with effect from April 2023, as announced in the Autumn Budget, will not be recognised until the legislative change is substantively enacted in 2022. It is currently estimated that this would result in a £12.9 million reduction in the value of the deferred tax asset.

# Risk management in TSB

### Approach to risk

TSB seeks to remain liquid, solvent, operationally stable, trusted, and compliant at all times. The objective of TSB risk management is to support and enable these outcomes. The processes to identify, measure and control the risks inherent in its business model are embedded in TSB's risk management framework. Risks faced by TSB in delivering its business strategy are managed in the context of the wider communities in which TSB operates and the Do What Matters Plan. TSB's approach to managing these risks is described below. TSB's principal risks and uncertainties are described starting on page 15.

### Risk management framework

The risk management framework creates coherent standards and practices for all risk management activities and processes in TSB. The framework is designed around a simple model for categorising risk so that all components of our risk management such as risk appetite, governance, policies, reporting, assurance and organisational design are aligned to the same hierarchy of risks. The five principal risk categories are shown in the table below.

| | |
|---|---|
| **Financial risk** | The risk of TSB having inadequate earnings, cash flow or capital to meet current or future requirements and expectations as they fall due. |
| **Credit risk** | The risk that a genuine or fraudulent borrower or counterparty fails to pay the interest or to repay the principal on a loan or other financial instrument as it falls due. |
| **Operational risk** | The risk of loss, damage or disruption arising from inadequate or failed internal processes, people and systems. |
| **Conduct risk** | The risk to the delivery of fair customer outcomes, or to market integrity. |
| **Financial Crime risk** | The risk that systems and controls are not adequate to manage financial crime within TSB's risk appetite and regulatory framework. |

### Accountability

Risk management is embedded at TSB through clear accountabilities across three independent lines of defence. This enables clear understanding and separation between functions that own and manage risks faced by the business (first line), provides oversight and challenge (second line), and provides independent audit and assurance (third line).

| | |
|---|---|
| **First line of defence** | • Identifies and manages risks in line with prescribed TSB risk management standards.<br>• Designs and implements control frameworks, preventative measures, processes and strategies to mitigate risks in line with risk appetite.<br>• Reports on its business unit and risk category risk profile and the effectiveness of control frameworks.<br>• Applies and embeds TSB risk management standards throughout the business through its policies, governance and control frameworks.<br>• Operates day-to-day control activities, tests and monitors the effectiveness of controls and compliance with policies and standards including business performance reviews, quality checking, and scenario analysis. |
| **Second line of defence** | • Sits within TSB's Risk Division.<br>• Maintains TSB's risk management framework and sets enterprise-wide standards for risk management activity.<br>• Provides independent oversight, support and challenge to the first line in managing risks to these standards.<br>• Monitors and oversees risk management activity in the first line and aggregates risk reporting to provide an enterprise wide view of TSB's risk profile and risk appetite to Board and Executive committees. |
| **Third line of defence** | • Provides independent and objective assessment of the risk management activities of the first and second lines.<br>• Reports on the effectiveness of risk management activities to senior management and the Board. |

Employees in TSB are individually accountable for identifying, assessing and managing risks within their area of responsibility. Risk management responsibilities are embedded through a risk focused culture, supported by efficient governance and achieved through a prudent risk appetite to support TSB's strategy.

### Risk culture

TSB culture is monitored by the Executive Committee and Board, and the importance of individual accountability for managing risk is reinforced by the approach to performance management and remuneration for all employees. Our aim is for both our employees and our customers to experience the benefits of a high performing culture, supported by a clear customer focus where employees feel confident that customers receive fair outcomes that meet a genuine need.

The Board measures culture through the Culture Dashboard. This provides insight into TSB's culture against nine traits so that actions can be identified to enhance a high performing environment. Throughout 2021, the culture and employee engagement roadmap has targeted and strengthened key drivers of customer focus and connection with TSB's purpose. TSB's Do What Matters Plan also sets clear commitments to improve the overall diversity of TSB, to better reflect the communities we serve, through the diversity of thinking across the Bank. TSB sets a consistent tone from the top, with senior leaders expected to act as role models for the TSB culture with actions that match their words, as well as encouraging a culture where everyone is safe to share ideas and speak up.

# Risk management in TSB (continued)

**Risk appetite**

TSB defines risk appetite as the amount and type of risk that it is willing to take in the pursuit of its objectives. Risk appetite is approved by the Board and ratified by Sabadell. Through regular meetings and reporting, the Board monitors performance against appetite and appropriate remedial action is taken to address any appetite breaches.

TSB has a clearly defined and proportionate risk appetite that supports its strategic objectives and seeks to provide confidence to its customers, regulators and shareholder. TSB is not a specialist lender and does not seek to differentiate itself as a provider of niche products. At the highest level, TSB aligns its risk appetite to UK mainstream retail banking. Risk appetite is calibrated to remain within the range of mainstream retail banking peers on every significant measure of risk.

TSB's appetite for risk is expressed through Attitude to Risk Statements. These are a series of qualitative statements providing the context for our underlying quantitative risk appetite measures and aligned to our strategic and business objectives. TSB's Risk Appetite Statement articulates desirable and acceptable levels of risk taking in the business, and ultimately influences decision making at all levels. It includes our Attitude to Risk Statements, our quantitative measures, and the thresholds we monitor our performance against.

**Risk governance**

Risk ownership and accountability sits with individuals, supported by governance and reporting via TSB's risk committees. These are aligned to the five principal types of risk as described in the table below. Each committee is responsible for monitoring TSB's risk profile and challenging risk exposures across the relevant risk type in line with the risk appetite set by the Board.

This committee structure enables efficient decision making, providing clear escalation and reporting of risk to Executive and Board Risk Committees, and to the Board which is responsible for providing oversight of the effectiveness of the risk management framework. A risk committee is aligned to each of our Level 1 risk categories to provide a dedicated focus on managing those risks.

| **Financial Risk (Asset & Liability Committee)** |
|---|
| Chaired by the Chief Financial Officer, the committee is responsible for the strategic management of TSB's balance sheet, the profit and loss implications of balance sheet management actions and the risk management framework for market risk, liquidity risk, capital risk, earnings volatility and economic value. |
| **Credit Risk Committee** |
| Chaired by the Chief Risk Officer, the committee is responsible for the coordination and aggregation of all credit risk management activity, management of TSB's credit risk profile, including credit risk appetite metrics and credit strategies, and TSB's compliance with all relevant credit regulation and legislation. |
| **Operational Risk Committee** |
| Chaired by the Chief Operating Officer, the committee is responsible for the aggregation and coordination of operational risk management across the Bank, monitoring and challenging the operational risk profile, including key operational risks and controls, and for ensuring appropriate escalation and visibility of relevant breaches, losses and events. |
| **Conduct Risk Committee** |
| Chaired by the Interim Customer Banking Director, the committee is responsible for the aggregation and coordination of conduct risk management across the Bank including delivery of substantially fair customer outcomes, compliance with relevant conduct regulation and legislation, monitoring and challenging the conduct risk profile, including key conduct risks and controls, and for appropriate escalation and visibility of relevant weaknesses, breaches, losses and events. |
| **Financial Crime Risk Committee** |
| Chaired by the Chief Risk Officer, the committee is responsible for assessing whether the risk of criminal conduct relating to money or financial services or markets is appropriately managed across TSB. The committee monitors and challenges the financial crime risk profile including key financial crime risks and controls, and ensures appropriate upward escalation and visibility of relevant breaches, losses and events relating to the financial crime risk categories. |

In addition, the Model Governance Committee, chaired by the Chief Risk Officer, is responsible for the development, implementation and effectiveness of the model governance framework (covering policies, methodologies, systems, processes, procedures and people). This includes articulating the extent and type of model risk to which TSB is exposed, acting as the Designated Committee as required by the Capital Requirements Regulation.

# Risk management in TSB (continued)

**Principal risks and uncertainties faced by TSB**
The Board closely monitors risks that have the potential to materially impact execution of strategy. For the majority of 2020 and 2021, TSB's key risk was the response to the impacts of the COVID-19 pandemic.

The Bank's response to COVID-19 resulted in enhancements and adjustments to the control environment across the Bank to better support our customers. This included facilitating working from home for most employees, adjusting the working environment for those employees that continued to work on-site, providing support to customers in financial difficulties, policy adjustments, supporting vulnerable customers, accelerating the availability of online forms for customers, and enhanced monitoring to enable TSB to respond quickly and effectively in supporting customers and employees.

The underlying credit performance remains strong and we continue to provide support to our customers. Our financial stability, operational resilience and customer outcomes are also key themes in the risks considered by the Board throughout 2021 and are detailed below.

| Description | Mitigation |
|---|---|
| **Threats to profit resilience** | |
| Continued market competition, increasing regulatory requirements and historic low interest rates have reduced profitability across the sector since the Financial Crisis.<br><br>The risk exposure to TSB remains following the COVID-19 pandemic and has evolved to include the potential for higher inflation and consequential increases in costs, negative impacts to the housing market with consequential LTV and equity challenges, changing customer behaviours and affordability leading to potential higher arrears rates. Conversely, improvements in the economic outlook could have a positive impact on credit quality, profit resilience and the sustainability of the TSB business model. | Various aspects of TSB's strategy have been accelerated to mitigate the impact of these risks, such as the digital transformation programme which responds to customer need, reduces costs, and improves efficiency.<br><br>A robust discipline is maintained to ensure that risk adjusted returns on new business are sufficient and credit adjustments have been made, where appropriate, so that customers continue to 'borrow well' in the current economic environment. |
| **Risk of a sustained or new systemic crisis** | |
| The shorter-term impacts resulting from COVID-19 continue to evolve but the outlook has improved significantly given the success of the vaccination programmes and Government support schemes.<br><br>Downside risks to UK economic performance remain given the potential impacts from new variants of the virus, uncertainty regarding consumer resilience, and the medium and long-term impacts from Brexit.<br><br>A more sustained crisis or further deterioration could exacerbate any future challenges on capital, long and short-term wellbeing of employees and operational resilience. | TSB remains well capitalised. The key risks to capital have been captured in the Bank's financial forecast and are being closely monitored. TSB continues to focus on identifying and delivering capital optimisation opportunities.<br><br>TSB continued to take a proactive approach to risk management during COVID-19, responding swiftly to customer needs and regulatory guidelines. This included waiving fees and interest charges, and implementation and monitoring of repayment holidays and other financial support measures such as the Bounce Back Loan Scheme.<br><br>The modelling of alternative trends in customer behaviour has been used to establish an effective operational response and tailored customer treatments following the conclusion of repayment holidays introduced in response to the COVID-19 pandemic.<br><br>While fraud levels increased across the industry, TSB continued to support customers through the industry's first ever Fraud Refund Guarantee.<br><br>TSB uses its established incident management framework to respond effectively and efficiently to incidents and the associated operational risks. Our response remains flexible to constantly evolving situations so that an acceptable level of customer service and operational stability continues to be provided. |

# Risk management in TSB (continued)

**Principal risks and uncertainties faced by TSB** (continued)

| Description | Mitigation |
|---|---|
| **Execution of strategy** | |
| During 2021 we have returned to profitability with strong business momentum. Our strategic intent for 2022 is to provide exceptional customer experience as a leading UK challenger bank.<br><br>However, economic uncertainty remains and the resource and capacity required to implement an elevated programme of regulatory change puts pressure on the pace of delivery of TSB's strategic agenda. | TSB is successfully delivering against its three year strategy plan, with continuing focus on our Money Confidence purpose, delivering for our customers, and making TSB more efficient.<br><br>Our risk appetite defines the amount and type of risk we are willing to take in pursuit of our strategic objectives and is closely monitored by the TSB Board.<br><br>Progress towards delivery of our key strategic programmes, alongside our regulatory obligations, is closely monitored monthly by the TSB Board. |
| **Management of customer harm** | |
| Societal and regulatory expectations continue to increase for higher standards of diligent and proactive management of potential customer harm. A new Consumer Duty will be introduced by the FCA in 2022 which seeks to address and prevent harms so that products and services are fit for purpose and relevant information can be accessed effectively by consumers.<br><br>Customer harm will have occurred if a customer has experienced material distress and/or inconvenience, obvious detriment or, in some instances, an unfair outcome. In the main this is likely to occur due to failures in systems, policy, process or controls. | The embedding of our risk management framework and maturing conduct risk management supports the proactive management of potential impacts on customers by identifying where customer harm may occur and has occurred.<br><br>The Executive Committee and Board receive regular management information on potential and actual customer harm, together with actions taken to prevent harm and address any weaknesses. Management is improving practices relating to the treatment of customers in collections and recoveries.<br><br>Investment has been made in our Financial Support Services capabilities ahead of an expected increase in volumes of customers requiring support following withdrawal of government support schemes.<br><br>Impacts of Consumer Duty have been, and are being, considered throughout the FCA consultation period. |
| **Data use, management and security** | |
| Without strong data governance practices, data could be mis-used, mis-interpreted, incorrect, or not available which could lead to customer detriment, poor decision making, incorrect reporting, regulatory censure, fines and issues of compliance with GDPR and BCBS 239.<br><br>As more services and customer interactions become digital, the potential impact of a successful cyber-attack grows. Each year there is an increase in the complexity and sophistication of attacks around the globe. Whilst all industries are targeted, the banking industry remains high on the criminal hacking agenda.<br><br>Without effective mitigating controls there is a significant risk that an attack could lead to service downtime and customer disruption, material data loss, financial loss, remediation cost, and reputational damage. | TSB has continued to focus on improving the monitoring and quality of customer data, maintaining a fully effective security control environment and building further capability to prevent and detect the evolving types of attack through continued investment in the right tools and technology. |

# Risk management in TSB (continued)

**Principal risks and uncertainties faced by TSB (continued)**

| Description | Mitigation |
|---|---|
| **Maintaining technical and operational resilience** | |
| Disruption to business activities across TSB, and the banking industry, remains a material inherent risk and an area of high importance to our customers and regulators.<br><br>With the reducing reliance on cash by our customers, the ability to maintain digital services to our customers and operational processing grows ever more important to prevent customer detriment, losses through rectifications, remediation costs, and to avoid reputational damage. | TSB has taken direct control of its technology estate from Sabis (Sabadell's IT subsidiary), transitioned services to new third parties, and built further capability in the technology function. Technological capabilities continue to evolve and, with increased transparency following the technology estate transition, we continue to focus on developing an effective and embedded technology control environment, building further resilience into our technology estate.<br><br>The necessary steps are being taken to comply and to demonstrate the resilience and interchangeability of key business services in light of the new Operational Resilience regulation. |
| **Challenge to attract and retain talent in a competitive market** | |
| A highly competitive employment market provides industry wide challenges in attracting diverse talent and retaining current staff. Resource challenges exist due to attrition and high levels of early turnover. | At TSB, creating a truly diverse and inclusive workplace is a key pillar in our Do What Matters Plan.<br><br>TSB continues to review its hiring processes and is working with external resource providers to recruit from wider geographies, enabled by our hybrid approach to work. |
| **Increased competition with lack of differentiation** | |
| Fintech and other technological advances create alternatives to the traditional value chain and ways in which banks currently operate and service customers.<br><br>Failure to develop our technology to keep pace with evolving customer needs may impact customer retention and lead to challenges in attracting new customers. | A core component of TSB's strategy is leveraging technology to improve digital services. TSB has identified its core customer base and the development of new products, services, and experiences are aimed specifically at meeting those customers' needs.<br><br>Examples include the launch of the Spend and Save current account, new mortgage products and features including digital residential product transfers, and partnerships with ApTap and Wealthify which help our customers make more of their money. TSB also differentiates itself through the award-winning Fraud Refund Guarantee scheme. |

## Emerging risks

The key emerging risks in TSB's operating environment are described below. TSB regularly considers the likelihood of the relevant risk materialising and the potential impact on its business strategy, customers, employees and shareholder. These risks are considered as part of the business planning cycle.

*Post COVID-19 related risks*

COVID-19 has generated significant instability and its full effects on the UK and global economy are not yet known. The longer term effect on market forces and customer behaviours could significantly impact strategy and TSB's business model. TSB has a strong liquidity and capital position and ensures this includes sufficient resources, with a buffer to cover any disruption. The approach to setting TSB's strategy considers a range of responsive and flexible strategic initiatives that can be deployed and adjusted as the landscape evolves.

*Risk of long period of high inflation*

A sustained period of higher inflation and the consequential potential economic impacts introduces risks of changing customer behaviours, affordability and increased challenges to TSB's cost base leading to potential pressure on capital. TSB undertakes detailed scenario analysis which captures stressed inflation situations and continues to monitor external economic factors and customer behaviour.

*Post Brexit regulatory and political impacts*

Potential challenges arising from divergence between UK and EU regulations and legislation. This includes increased costs, complexity and risks associated with compliance. Cross-border compliance strategy is being actively managed by business areas.

# Risk management in TSB (continued)

**Emerging risk - climate change**

A Climate Change Executive Steering Committee has been established to address financial and transition risks and embed effective risk management actions. The management of financial risks from climate change has been incorporated within TSB's existing risk management framework.

Climate change risk is a cross-cutting TSB risk, impacting a range of risk categories to varying degrees. By integrating the identification, measurement, monitoring and management of climate-related risks into our existing risk management framework we aim to take a consistent and proportionate risk management approach to prevent potential harm to our customers and avoid adverse financial impacts. Through a clear understanding of the action required to tackle the risks of climate change, we aim to identify opportunities that will benefit our customers and other stakeholders.

*Governance*

The Board provides strategic direction on both the Bank's climate change approach and its fit within the Do What Matters Plan using the regular updates and mechanisms described below. The Chief Risk Officer and Chief Financial Officer have responsibility for TSB's approach to managing the financial risks from climate change, including the embedding of climate change risks within the existing risk management framework, development of scenario analysis, embedding climate change within governance and complying with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The Risk Committees, as referenced in the Risk Governance section (page 14), maintain a forward-looking view of TSB's risk profile taking into account the financial risks from climate change.

Throughout 2021 a Climate Change Steering Committee, with senior leaders from relevant areas of the bank, met monthly to manage the embedding of actions to comply with the PRA's Supervisory Statement 3/19 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change'. This Steering Committee reported to an Executive Steering Committee, co-chaired by the Chief Risk Officer and Chief Financial Officer. The output from the Executive Steering Committee is reported to the Board Risk Committee to ensure a holistic on-going consideration of TSB's climate risk approach. This has been further supplemented by regular deep dive updates at senior committees and ongoing dialogue with the PRA.

During 2022, internal reporting on climate change will be provided regularly to senior committees to allow continued embedding within strategic planning and forecasting processes. This quarterly reporting will highlight the risks and opportunities that climate change presents to TSB, as well as progress against relevant targets and metrics.

*Risk Management*

TSB views climate change as causal risk that manifests through our established risk categories (Financial, Credit, Operational, Conduct & Financial Crime). We used our existing risk management framework to assess the impact of climate change across these risk categories by determining where the largest impacts would emerge (see risk section below) and assessing the impact on controls, policies and risk appetite measures. By using our existing, established framework the significance of climate-related risks has been assessed in comparison to our other risks. The assessment of climate-related risks has been integrated with the bank's six-monthly risk and control assessment.

During Q4 2021, TSB launched a bank-wide training and communication programme focused on the impact of climate change and TSB's response to it. The Bank's existing regulatory horizon scanning process ensures that TSB continues to consider and respond appropriately to existing and emerging climate change regulatory requirements and guidance, for example, the PRA's Climate Change Adaptation Report 2021.

*Strategy, risks and opportunities*

The banking industry is on a journey to adapt to the risks and opportunities that climate change may bring. TSB is taking a proactive and cohesive bank-wide approach to identify and manage both risks and opportunities, putting us in a strong position to safeguard the resilience of our strategy.

The key risks to TSB are currently considered to be relatively small and are likely to materialise over a medium to long-term time horizon. We are closely managing those risks through existing well-established processes which dovetail with our approach to setting strategy. We are also closely monitoring regulatory, societal, market and political developments to ensure we continue to adapt our strategy as required to maximise opportunities.

A clear climate strategy has been set by the Board, and the impacts of climate-related risks and opportunities have been considered as part of TSB's business, strategy and financial planning processes. The Director of Financial Planning and Analysis and Director of Credit Risk Measurement jointly lead the activities in our climate change scenario analysis workstream, where the materiality of potential climate scenarios in financial planning is considered. Key stakeholders responsible for forecasting activity are members of the climate change steering committees and have responsibility for feeding into the planning process, including climate related product and service initiatives together with the investment required to meet our climate-related commitments as described on pages 27 to 29.

# Risk management in TSB (continued)

**Emerging risk - climate change (continued)**

*Strategic initiatives*

In January 2021, TSB published its pathway to reach operational net-zero carbon emissions by 2030, a key commitment in our responsible business strategy, the 'Do What Matters Plan'. As a member of the United Nation's Net Zero Banking Alliance, TSB has committed to aligning its lending portfolio with net-zero emissions by 2050. TSB will deliver a net-zero carbon pathway that meets international standards that is independently validated by the Science Based Targets initiative. This is supported by TSB's membership of the Partnership for Carbon Accounting Financials. Details of our pathway to further reduce the carbon emissions from our own operations, baseline the wider environmental impacts of our business and how we are helping our customers reduce their environmental impact are outlined on pages 27 to 29.

Customer sentiment is accelerating in favour of 'green' propositions, with 60% of TSB customers saying that it's important for TSB to help customers reduce their carbon emissions[1]. This creates both opportunity and the potential for risk for TSB. As housing stock represents one of the biggest influences on climate change, TSB's initial environmental product innovations focus on our mortgage portfolio. Further information on how we are helping customers to mitigate their climate impact, the launch of our new Green Additional Borrowing product proposition and our New Build mortgage proposition is outlined on page 29. We will continue to explore opportunities to launch further green propositions over the medium and long-term across all product categories where we believe they can make a tangible difference to our commitments, meet customer needs and are commercially viable.

In addition, debt and capital markets are increasingly exploring sustainable funding and capital transactions. These transactions typically result in more successful outcomes due to greater investor interest and can potentially lead to more favourable funding costs due to oversubscription levels. Data collection is, typically, one of the biggest hurdles to mobilising such transactions. TSB is currently reviewing the data requirements for green funding transactions and has ambition to develop the ability to issue green and social bonds.

As reflected above, and further outlined on page 27, TSB has developed a pragmatic environmental strategy as part of the Do What Matters Plan. It is structured around the following four key priorities, as further described in the Being a responsible business section on pages 27 to 29:

- reduce the environmental impact of our own operations by becoming operational net zero no later than 2030;
- help customers reduce their impact on the environment;
- help colleagues reduce their impact on the environment; and
- collaborate with suppliers to deliver meaningful and beneficial environmental programmes.

*Risks*

Throughout 2021, our existing risk assessment processes have been used to develop our understanding of the climate-related risks faced by TSB. This, complemented by scenario analysis, has allowed us to assess the impact of those key climate-related risk drivers over the short (1-5 years), medium (10 years) and long term (30 years).

The financial risks from climate change arise in two main ways, physical risk and transition risk. With TSB's lending portfolio predominantly comprised of mortgage assets (93%), the main physical risks for TSB are the flooding, subsidence, and coastal erosion (medium and long term) risks associated with the secured portfolio. From a transition perspective the main risks arise from the poor energy performance of the properties on which mortgage lending is secured and the risks associated with the cost for improving property energy ratings (short, medium and long-term). The macro-economic impacts of different climate pathways to low carbon transition may also impact TSB. Our secured lending portfolio has been analysed to identify exposure to both physical and transition risks across a number of scenarios (see Scenario Analysis section below).

We continue to monitor and comply with evolving regulations around climate change.

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[1] Sample: 886 TSB customer from our internal Bank NPS survey in April 2021.

# Risk management in TSB (continued)

**Emerging risk - climate change (continued)**

*Scenario analysis*

We use scenario analysis to help inform the identification and measurement of climate-related risks, ensuring their mitigation and management are embedded in our strategy, risk appetite, financial planning and capital management processes as they become more material over time.

TSB's scenario analysis capabilities have further matured in 2021, building on prior year assessments, by completing detailed quantitative assessments of the physical and transition risks to our core secured portfolio.

Whilst TSB is not obliged to assess the Bank of England's Climate Biennial Exploratory Scenarios, TSB's scenarios have been aligned with these scenarios (which take account of early, late and no additional policy action) where possible. TSB will participate in the ECB Climate Stress in 2022 as part of the consolidated Sabadell group review.

A high-level qualitative assessment of physical and transition risks of the remaining lending portfolios is being undertaken, reflecting their lower potential impact. The results from this assessment are being used to further inform and enhance our strategy, risk appetite, financial planning and capital management processes.

Scenario analysis is recognised as a valuable activity to develop our understanding of and shape our response to the climate risks inherent within TSB's business model. As a result, we continue to build the level of sophistication in our scenario analysis and have plans to continue to improve our modelling and data capabilities in 2022.

*Metrics and Targets*

Our risk appetite defines the amount and type of risk we are willing to take in pursuit of our strategy. Our 2022 Risk Appetite Statement includes an expanded list of climate change metrics to monitor and assess the key physical and transition risks associated with our mortgage book. Our measures report the flow of mortgage lending to properties vulnerable to flooding, and new lending to properties categorised by energy efficiency ratings. The flow of lending to less energy efficient properties is now monitored monthly by the Board.

In line with good practice and regulatory expectations we review our risk appetite to reflect any material changes to strategy, market conditions, material events on a, minimum, annual basis. During 2022, appropriate operational risk climate metrics will be considered, linked to our targets and objectives around property decarbonisation, net zero commitments, and supplier climate impacts. We will also ensure our risk appetite aligns to any broader goals that emerge from setting Science Based Targets through the Science Based Targets Initiative (SBTi) in 2022.

See pages 27 and 28 for details of our energy, carbon and emissions reporting.

# Being a responsible business

## TSB’s Do What Matters Plan

With origins going back to the start of the savings bank movement in the nineteenth century, TSB has always been committed to its wider role in society and to help communities thrive.

In July 2020, we took forward this commitment with the launch of the Do What Matters Plan, a long-term programme that aligns to TSB’s purpose of Money Confidence. For everyone. Every day. It focuses on doing what matters for customers; small businesses; colleagues; communities; and the environment. Each pillar of the programme is sponsored by a member of the Executive Committee, and its key goals are to:

- Help customers have Money Confidence;
- Treat businesses fairly and help them grow;
- Create a truly inclusive workplace;
- Work locally with our communities to help them thrive; and
- Reduce our impact on the environment while helping customers and colleagues do the same.


Now in its second year, the programme is well established and delivering against all of its goals.

TSB has taken leading positions on tackling fraud, paying small suppliers promptly, hiring and promoting women into senior roles and protecting victims of domestic abuse, much of which builds on existing activity. In 2021, more has been done to help vulnerable customers, support SMEs, promote diversity and inclusion in our workforce, support communities and reduce our impact on the environment.

We continue to embed the programme into our business to amplify action and deepen its impact. Delivering on the commitments within our Do What Matters Plan is one of TSB’s Primary Corporate Objectives and features in every colleague’s personal delivery plans. In our latest colleague experience survey, in October 2021, 86% of those who responded, understand their role in helping TSB achieve its Do What Matters Plan.

Training and the development of our colleagues will remain a priority as we believe that informed and passionate colleagues are the best catalysts for positive change, as well as being advocates for the positive contribution that our business makes to wider society.

We are proud to be the first high street bank accredited by the Good Business Charter, a national accreditation scheme that recognises businesses that behave responsibly. We have also become signatories to the UN Global Compact corporate responsibility initiative and its principles on human rights, labour, the environment, and anti-corruption.

You can find more information about the progress we’re making at www.tsb.co.uk/do-what-matters.

GBC Good Business Charter Accredited

# Being a responsible business (continued)

**Customers: Helping customers have Money Confidence**

Doing what matters for customers

Customers

**Doing what matters for our customers is at the heart of TSB's purpose: providing 'Money Confidence. For everyone. Every day.' helping them to manage their money better. This purpose has become even more relevant throughout the pandemic as we see changes in the way many of our customers feel about managing their money and the impacts on household finances.**

- Like many other customer-facing businesses, we have seen a significant and sustained shift in the way consumers bank with us. Despite many of our customers now using online and digital banking services, we remain committed to a branch network across Great Britain. Following the closure of the 70 branches announced in November 2021, TSB will operate a network of 220 branches across Great Britain.

- We have invested in upgrading 135 of these branches, to help us deliver the best experience for our customers. In addition, we have over 40 pop-up services, located in libraries, community centres and other civic amenities, in towns where the distance between our branches is significant. We have more than 100 trained Mobile Money Confidence Experts, with 50 of these serving customers directly in pop-ups across the country. We are also a founding member of the Cash Access Group, piloting Banking Hubs across the country.

- All customer-facing employees completed training to equip them to help customers develop the skills and explore the services and products they want and need to boost their money confidence. We are ahead of schedule to meet our longer-term ambition to have one million 'Money Confidence' conversations by the middle of 2023 and expect to reach this target within the first half of 2022.

- Digital services continue to be further enhanced with additional features in the TSB Marketplace, available through the mobile app, including features such as ApTap, a subscription and bill switching service to help customers save money on their everyday bills.

- During 2021, our commitment to refund every TSB customer who is an innocent victim of fraud continued to be met. TSB has refunded 97% of all fraud cases since introducing the Fraud Refund Guarantee in April 2019. This compares with an industry wide refund rate of only 42%. We continue to offer advice in our weekly column in The Sun newspaper to help people avoid becoming a victim of fraud covering emerging scams, new attacks and providing support on new industry initiatives, such as confirmation of payee and contactless payments.

- To help customers become more confident with their money, we share Money Confidence content on TSB.co.uk. During 2021 this site was visited by more than 50,000 people and reached a further 3.3 million through social media channels.

# Being a responsible business (continued)

**Businesses: Treating businesses fairly and helping them grow**

Doing what matters for businesses

Businesses

**Doing what matters for small businesses focuses on treating them fairly and helping them grow, through prompt payment of suppliers, providing access to business support and advice to customers, and encouraging diversity and responsible practices with suppliers and business customers.**

- In 2021, as part of our commitments as a signatory of the Prompt Payment Code, a Government-backed voluntary code of practice, we paid 97% of all suppliers within 30 days and in an average of 9 days. We also prioritise our small and medium suppliers and paid 97% of them in an average of 7 days. TSB's approach to prompt payment has been highlighted by the Small Business Commissioner as best practice.
- In November 2021, we launched Revenu app for NatWest business customers who switch their Business Current Account to TSB. Also, we launched an app, in partnership with BankiFi, that helps our business customers get paid faster, save time on administrative tasks and keep on top of late payments. As part of its functionalities, users can send digital requests for payment to their customers through digital mechanisms such as SMS, WhatsApp or email, or through the use of a QR code. This supports our commitment to help small businesses get paid faster.
- We delivered a programme of 32 events and initiatives, reaching over 2,450 small businesses, which addressed subjects such as access to finance, cashflow management and impacts of COVID-19 on the SME sector. We also delivered support to small businesses by launching an online business support portal in partnership with Be the Business, an independent, not-for-profit organisation, to help business owners and leaders improve the performance of their business.
- We engaged over 20,000 female entrepreneurs through the Entrepreneurial Women campaign, in partnership with Enterprise Nation, providing access to inspiring events, relatable role models and inclusive business support.
- Over 10,000 businesses chose to switch to TSB through the Government's Incentivised Switching Scheme, making us one of the best performing banks in the scheme. This led to TSB being awarded additional funds by the Banking Competition Remedies Board to help drive further competition in the business banking market.
- Over the course of the COVID-19 pandemic we saw a five-fold increase in our lending to SMEs, including over £615 million in Bounce Back Loans to 25,000 businesses.

# Being a responsible business (continued)

**Colleagues: Creating a truly inclusive workplace**


**We want TSB to be a truly inclusive organisation where everyone feels welcome and with access to equal opportunities. In an increasingly mobile external labour market, we are focused on collaborating with colleagues to continue developing attractive, engaging and inclusive ways of working, and supporting the development of future-focused skills.**

- To deliver on our ambition we have published goals to build a workforce that reflects the diversity of the UK working age population. Our goals include the gender and ethnic diversity of our senior leadership team, and representation of Black, Asian or Minority Ethnic colleagues, disabled colleagues and LGBTQ+ colleagues in our workforce.

*Diversity of our workforce*

- During 2021 significant progress has been made to achieve a truly diverse workforce that reflects the UK working age population by 2025. The number of senior roles held by women increased to 41% (2020: 40%), above the industry average of 34%. Asian and Minority Ethnic representation in senior roles also increased, with overall Black, Asian and Minority Ethnic representation reaching 9% (2020: 8%). However, we recognise that the increase in Black representation was slower, and consequently, a targeted Black talent plan is now in place to drive progress in 2022.

- To develop a truly inclusive culture we continued to support an intersectional Inclusion network with executive level sponsors for TSB Ability, Ethnicity, Gender Balance and LGBTQ+. These networks actively challenge and contribute to diversity and inclusion plans by hosting conversations with colleagues throughout the year on topics such as career confidence for women, non-visible disabilities, transgender awareness and Black History Month. 90% of colleagues agree that TSB promotes an inclusive work environment that accepts everyone's individual differences.

- We continue to collect data to help build an understanding of and target the removal of barriers to social mobility in financial services and have set an ambition to be included in the top 75 companies of the Social Mobility Employer Index. TSB was the first UK bank to participate in the UK government's Kickstart scheme, offering 15 placements. We are delighted that, to date, seven of our placements have secured permanent roles at TSB, with a further three securing other long-term career opportunities.

- In 2021, a new framework of six mentoring programmes was launched to support colleagues at all levels in TSB. This programme was established with the support of a new partnership with Moving Ahead and will help almost 200 colleagues to build career confidence and remove barriers to progression. This is critical in developing diverse internal talent pipelines.

- We continue to hold ourselves to account against the highest standards and support the drive for industry-wide progress. In 2021, TSB signed up to the Change the Race Ratio and Black Talent in Finance and Professions Charter, two initiatives designed to accelerate racial and ethnic diversity in business. We also received Level 2 Accomplished Carer Confident Accreditation from Carers UK.

*Disability inclusion*

- TSB is a Level 3 Disability Confident Employer. We have a strong focus on disability and seek to ensure that employees with disabilities are treated fairly and can compete on equal terms for career progression. TSB commits to offer an interview to disabled people who meet the minimum criteria for a job while new training in the features of TSB's digital workplace is helping to reduce barriers to accessibility.

- We listened to employees with disabilities and long-term health conditions on the benefits and challenges of remote working to help design TSB's future ways of working while the introduction of a Workplace Adjustment passport has helped to reduce barriers to mobility across the business. Continued provision of Unmind and new employee assistance programme provided by BUPA helps all TSB employees take care of their mental wellbeing and, to support our leaders to be confident to have conversations about wellbeing, a mental health module is included in the TSB Manager Programme.

- We also delivered mental health training, in 2021, to all colleagues who talk to customers and nearly half of TSB line managers completed unconscious bias and mental health awareness training throughout the year.

# Being a responsible business (continued)

**Colleagues: Creating a truly inclusive workplace (continued)**

*Involvement of employees in business / consulting with employees*

- Collaborative, open, honest, two-way communication is encouraged at all levels to promote the involvement of employees in the business. As employees have continued to adjust to different ways of working in 2021, TSB has focused on maintaining channels of communication to support a speak up culture and maintain connections between individuals and teams, supported by TSB's digital workplace. This includes TSB's employee forum, The Link, which has met four times in 2021, providing a direct connection between employees and executive leadership. The Link also reports annually to the Board.

- We also continue to work closely with our recognised unions, Accord and Unite, to build strong relationships. During 2021, we held weekly conversations around the health, safety and wellbeing implications for all employees from TSB's response to the COVID-19 pandemic. Reflecting on feedback from our employees, we introduced a new hybrid ways of working model that provides colleagues with more flexibility in their working environment. We have developed our approach in which each of our teams have their own Team Charter document that is regularly reviewed and discussed to allow our employees to feedback and our managers to listen and adapt. This has been implemented across the business and further feedback will be sought from colleagues in assessing the optimal model.

- TSB's annual colleague experience survey, called 'Your Say Matters', provides employees the opportunity to feedback on working at TSB, with a roadmap developed to address the key findings. This has driven a 12 point increase in engagement levels across TSB in 2021 compared to engagement in 2020.

- TSB also encourages the recognition and celebration of colleagues' contribution and behaviours. July 2021 saw the first anniversary of the Spotlight programme which gives employees the opportunity to recognise exceptional contributions from fellow employees who demonstrate exemplary TSB behaviours. During 2021, more than 105,000 recognitions were awarded through the programme.

- We continue to provide all employees the opportunity to invest in TSB's shareholder through participation in our income tax and national insurance efficient all-employee Share Incentive Plan.

# Being a responsible business (continued)

**Communities: Working locally with our communities to help them thrive**


**TSB has always taken seriously its responsibilities in the communities that it operates in. We seek to extend our impact, building on what we've done well for some time, including donating our time and money to vital local projects and helping the people who need it most.**

- During 2021, we supported 68 charities through the TSB Charity Partnership Programme. Launched in 2020, and shaped by input from hundreds of TSB colleagues, the programme helps organisations across Britain to carry out crucial work in our communities which support vulnerable people, mental health, cancer care, homelessness and help the disadvantaged. Colleagues across the bank have now raised over £100,000 to support these causes since the start of the programme.
- A pilot scheme to provide access to banking services for homeless people in Scotland was launched in July 2021 in partnership with the Simon Community Scotland. This seeks to address a key barrier for the homeless in securing a job and obtaining other important support. Previously, opening an account with most banks was particularly challenging for those without a fixed address. This scheme aims to provide more people with the security of banking services, which they can access digitally or in a branch.
- During 2021, TSB became the first bank to offer a safe space to victims of domestic abuse under the charity Hestia's Safe Space initiative. More than 1,500 TSB branch colleagues have received specialist training to increase their confidence in responding to disclosures of domestic abuse and can provide victims with access to the Safe Space in their branch.
- We also encouraged colleagues to spend up to eight hours of their paid working time in supporting a good cause by donating their time and skills. Since August 2020, colleagues have volunteered more than 9,000 hours with more than a third of these hours delivered through the volunteering programme with Citizens Advice. This has seen TSB colleagues, with the right skills, spending some of those hours at Citizens Advice offices directly helping clients, and others sharing their knowledge through a series of masterclasses or taking part in a mentoring scheme. Outside of this, TSB colleagues have joined the NHS Jabs Army to help the fight against COVID-19, worked within their communities to clean up litter and support a range of local initiatives.
- Heroes in our communities were again recognised through our partnership with Pride of Britain and the TSB Community Award. We supported the Pride of Birmingham TSB Community Hero, Hannah Borg, to increase the scope of her charity, Cherished, to help young girls and boys to find the confidence to fulfil their potential. In Manchester, we're helping TSB Community Heroes, Claire Wright and Chris Squires and their Trafford Veterans charity to redevelop an old bus into a setting to provide support for military veterans suffering from Post-Traumatic Stress Disorder. In addition, we're looking forward to working with Jamie McCallum and Rebecca Carless, winners from the Pride of Scotland and Pride of Britain, to help their 'Wouldn't change a thing' charity, that aims to challenge negative perceptions of Down's Syndrome.

# Being a responsible business (continued)

**Environment: Reducing our environmental impact while helping customers and employees do the same**


**Doing what matters for the environment is an increasingly important consideration for customers, colleagues and a range of stakeholders, including regulators. Compared to many financial institutions, TSB is a relatively simple business and, to reflect this, we have developed a pragmatic environmental strategy. It is designed to align with emerging practice in the banking industry, to reduce our impact on the environment, and meet the highest international standards.**

- Our goals are focused on reducing our impact on the environment while helping our customers and colleagues to do the same. Our environmental strategy considers emissions from our own operations (Scope 1 and 2 greenhouse gas emissions) as well as our downstream impacts, for example, from our mortgage products and supply chain (Scope 3 greenhouse gas emissions).
- As outlined in the disclosures required to comply with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, set out on pages 18 to 20, our strategies are aligned under four broad themes.

*Reduce the environmental impact of our own operations by becoming operational net zero no later than 2030*

- In January 2021, we committed to achieve net zero emissions from our own operations (Scope 1 and 2 greenhouse gas emissions) by 2030, alongside signing up to the Science Based Targets initiative, which requires us to set credible absolute and net zero targets by the end of 2022. This year TSB also joined the Net-Zero Banking Alliance (NZBA), an industry-led, UN-convened alliance of banks worldwide, committed to aligning their lending and investment portfolios with the goals of the UN Paris Agreement by 2050, or sooner.
- Our operational emissions arise from heating and cooling the TSB property estate and from company cars (Scope 1), and electricity consumption (Scope 2). Scope 3 emissions that are reported relate to TSB's business travel, waste, water and paper usage. We have conducted initial analysis of other Scope 3 categories including purchased goods and services, and mortgages which we will further refine in 2022. In 2021, TSB joined the Partnership for Carbon Accounting Financials (PCAF) UK to support analysis of Scope 3 emissions from the mortgage portfolio and, as members, are engaged with the PCAF UK Residential Mortgages Working Group.

  Summary of Streamlined Energy and Carbon Reporting (SECR)
- The table below reflects TSB's greenhouse gas emissions as required by the UK Streamlined Energy and Carbon Reporting (SECR) Regulations for a 'large unquoted organisation'. The data has been compiled in accordance with the GHG Protocol Corporate Accounting and Reporting Standard, and independently audited by Concept Energy Solutions Limited. Further information on TSB's methodology and full SECR reporting table can be found at https://www.tsb.co.uk/secr-data-and-methodology-report.pdf. This year we have expanded Scope 3 to include business travel, water, waste and paper. TSB's total energy consumption, as measured on a location[1] basis, reduced by 20% in 2021 compared to 2020, and 28% versus our 2019 baseline.

| **Summary of Streamlined Energy and Carbon Reporting** | **2021** | **2020** | **2019** |
|---|---|---|---|
| **Emissions – Location-based [1] in gross tonnes of carbon dioxide equivalent (tCO2e[2])** | | | |
| Scope 1 emissions from the combustion of fuel and operation of facilities [3] | **2,171** | 2,761 | 3,010 |
| Scope 2 emissions from the purchase of electricity [4] | **4,267** | 5,561 | 7,139 |
| **Total scope 1 and 2 location-based emissions** | **6,438** | 8,322 | 10,149 |
| Scope 3 emissions from business travel, waste, water and paper | **745** | 1,509 | 3,330 |
| **Total Scope 1, 2 and 3 location-based emissions** | **7,183** | 9,831 | 13,479 |
| | | | |
| **Intensity ratio [5]** | **1.2** | 1.4 | 1.7 |
| **Energy consumption kWh (million) [6]** | **31.378** | 39.310 | 43.720 |

(1) Location-based emissions are those measured using the UK national grid electricity conversion factors, updated annually.
(2) tCO2e – tonnes of carbon dioxide equivalent.
(3) Scope 1 emissions: gas, heating oil, fugitive gas, and company cars.
(4) Scope 2 emissions: direct commercial electricity supplies plus landlord data where available.
(5) Calculated as the sum of Scope 1, 2 and 3 location-based emissions divided by the average annual headcount.
(6) Scope 1, 3, and energy consumption totals include both mandatory and voluntary elements of SECR reporting.

# Being a responsible business (continued)

**Environment: Reducing our environmental impact while helping customers and employees do the same**

*Reduce the environmental impact of our own operations by becoming operational net zero no later than 2030 (continued)*

- The table below reflects TSB's net operational emissions (Scope 1 and 2) after accounting for the purchase of REGO certified renewable electricity and Gold Standard verified carbon removal credits. In 2021, compared to our 2019 baseline, Scope 1 and 2 market-based emissions reduced by 74% to 2,171 tonnes of carbon dioxide equivalent (tCO2e). Scope 3 emissions have reduced by 78% compared to 2019. These reductions were due to a reduction in the estate, impacts of COVID-19 on business travel and building use, and implementation of paperless processes.

| **TSB greenhouse gas emissions data** | **2021** | **2020** | **2019** |
|---|---|---|---|
| **Emissions – Market-based(1) in gross tonnes of carbon dioxide equivalent (tCO2e(2))** | | | |
| Total Scope 1 and 2 emissions(3) | **2,171** | 2,761 | 8,284 |
| Verified carbon removals (offsets)(4) | **(2,171)** | (2,761) | – |
| **Net Scope 1 and 2 market-based emissions(5)** | **–** | – | 8,284 |
| Total Scope 3 emissions tCO2e(6) | **745** | 1,509 | 3,330 |
| **Total** | **745** | 1,509 | 11,614 |
| | | | |
| **Resource consumption data** | | | |
| Paper (tonnage) (7) | **583** | 984 | 1,439 |
| Water ($m^3$) | **47,238** | 67,409 | 86,469 |
| Waste (tonnage) (8) | **1,200** | 1,452 | 1,036 |
| Waste Diverted from Landfill | **99.7%** | 99.4% | 97.1% |

(1) Market-based emissions are those associated with the purchase of REGO certified renewable energy which carry zero-rated emissions. TSB began purchasing REGOs in October 2019.
(2) tCO2e – tonnes of carbon dioxide equivalent.
(3) Scope 1 and 2 emissions: Natural gas, fugitive gas, heating oil, company cars, electricity (100% REGO certified).
(4) Gold Standard carbon removal credits registered on the Gold Standard Impact Registry.
(5) Net Scope 1 and 2 emissions are total market-based emissions minus verified carbon removals.
(6) Scope 3 location-based emissions: Business travel (air travel, train, hotels, rental cars and employee-owned vehicles where TSB is responsible for purchasing the fuel), waste, water and paper consumption.
(7) Paper: Total tonnage arising from office and branch paper purchases, print and mail and marketing activities.
(8) Waste: Total tonnage arising from office and branch waste, destruction of archived documents and project waste including activity from the Branch Closure Programme (BCP). BCP activity resulted in an increase in waste in 2020.

- The procurement of renewable energy was an important first step towards net-zero, as it contributed to a reduction in emissions of 66% in 2020 compared to 2019. TSB continued to procure 100% REGO certified electricity in 2021 and is committed to continue to purchase renewable energy going forward.

- Following detailed analysis of energy data and asset information across the estate in 2021, a property estate decarbonisation and energy efficiency programme was established to support our transitional plan to achieve operational Net Zero for Scope 1 and 2 emissions by 2030. In order to achieve this TSB has worked closely with our facilities management provider to embed sustainability in their decision-making processes, particularly in respect of reactive maintenance activities across the estate. Together, we were 2021 finalists in the Institute for Workplace and Facilities Management (IWFM) Impact Awards in the 'Positive Climate Action' category in recognition of our collaboration on sustainability. This year we have also started the phased implementation of LED lighting across the estate to support a reduction in consumption of electricity.

- The reduction in Scope 1 and Scope 2 emissions outlined in the tables above also reflects the reduction in the size of the TSB branch portfolio as sites are closed and sold. The pandemic and new ways of working have also impacted the usage of the office estate which has also contributed to reductions in emissions, with Scope 1 and 2 emissions reducing by 21% in 2021 compared to 2020.

- In 2020, TSB set a target to reduce business travel by 50% by the end of 2021 versus the baseline established in 2019. The COVID-19 pandemic has played a significant part in the reduction of business travel emissions with a 92% reduction in 2021 versus the 2019 baseline. We have committed to support new ways of working and promote alternative modes of transport to maintain this reduction in emissions.

- TSB also has a paper use reduction target of 25% by the end of 2022 compared to 2019. Several initiatives have been launched to digitise processes and brochures, reduce customer mailings, reduce the printer fleet and maintain a 'think before you print' mindset as employees return to the office. In 2021, a 60% reduction has been achieved compared to 2019.

- In addition to supporting ArBolivia Phase II, a Gold Standard carbon removal project, TSB also supports UK Woodland and Peatland Carbon Code accredited projects as part of our wider approach to nature based solutions with our partner Forest Carbon.

# Being a responsible business (continued)

**Environment: Reducing our environmental impact while helping customers and employees do the same**

*Helping customers reduce their direct and indirect impact on the environment*

- In June 2021, we launched the Green Additional Borrowing mortgage product to support customers seeking to improve their homes, for example, with solar panels or insulation to make them more energy efficient and reduce their environmental impact and utilities cost. In November 2021, we piloted a mortgage for new build homes that are more energy efficient. We are exploring how this can be further progressed in 2022. More information can be found on TSB's dedicated green mortgages webpage.
- We digitised more banking service processes including the introduction of e-Certificate of Title mortgages which has helped to reduce paper consumption and accelerate the conveyancing process. More use has been made of automated mortgage valuation processes which has helped to reduce travel emissions associated with more traditional valuation techniques.
- Our established Plant-a-Tree initiative with eForests continued in 2021 where a tree is planted for every house purchase mortgage taken by a customer to help mitigate the climate impact of moving home. Since we launched this initiative, more than 38,000 trees have been planted in woodland and nature reserves in England, Scotland and Wales.
- Our partnerships with Wealthify and ApTap also support our customers to make greener choices through their investment choices or by switching to a green energy provider. At the end of 2021 we also launched the CoGo open banking app to enable customers to measure and reduce their carbon footprint.

*Collaborate with suppliers and partnerships to deliver meaningful and beneficial environmental programmes, and embedding sustainability in procurement processes*

- Collaborating with our suppliers is a key step to better understand and identify ways to reduce the emissions associated with the products and services that we purchase. In 2021, we have conducted an initial baseline of the emissions associated with the products and services purchased from our top suppliers and have identified several opportunities to work together to improve data collection and reduce emissions.
- In 2021 we adapted our procurement processes to include sustainability requirements into our due diligence and onboarding processes and have carried out targeted training for our supplier relationship managers on sustainability and Scope 3 emissions.
- We also ran a Net Zero workshop with some of our smaller suppliers in conjunction with Small Business Britain and Small 99 to educate and inspire action to measure and reduce their environmental impact.
- In 2021, TSB partnered with waste and resource management specialists N2S and GoGreenSolutions to reuse and recycle IT equipment and furniture from our branch closure programme. More than 15,000 IT assets and 11,500 items of furniture have been reused by TSB, refurbished for resale or donated to charity, or recycled, with zero waste going to landfill.

*Help colleagues reduce their direct and indirect impact on the environment*

- Engaging with employees is key to improving sustainability at work and at home. On 22 April 2021 (Earth Day), the TSB Green Team was launched. This employee led forum helps colleagues to understand and reduce their environmental impact. Around 400 colleagues (7% of the workforce) have engaged with this initiative, sharing ideas and best practices, and getting involved with volunteering activities.
- Our first Sustainability Hackathon was delivered in partnership with Microsoft, which saw around 70 colleagues form cross-functional teams and develop proposals to support employees and customers to be more sustainable. Ideas were presented to an Executive judging panel with prioritised initiatives to be progressed as part of the Do What Matters Plan.
- In March 2021, the Electric Company Car scheme was launched for our colleagues in managerial and more senior grades with fully electric vehicles now accounting for 67% of the fleet by the end of 2021, compared to 6% at the beginning of the year. We are reviewing how we can expand this further in 2022 for more colleagues. We also recently enhanced our flexible benefits scheme by increasing the Bike to Work scheme allowance for colleagues that want to purchase an electric bike.
- We ran 'Recycle Week' and 'COP26 Green Festival' events, with support from expert external speakers, to influence and inspire colleagues to take action. In addition, training needs relating to climate change were reviewed in 2021 and resulted in the launch of our Do What Matters for the Environment internal e-learning module, designed to help colleagues engage further in our plans to address the impacts of climate change across the organisation.

# Section 172 statement

In overseeing delivery of TSB's purpose and strategy, TSB's directors are always mindful of their duties under the Companies Act 2006, including as set out in section 172. The Board recognises that TSB's long-term success is only possible through engagement with, and having regard to, the interests of key stakeholders.

TSB's governance framework seeks to ensure that the Board appropriately considers stakeholders in decision-making. The Board monitors and challenges progress in the performance of the business through its review of the level of achievement of TSB's Primary Corporate Objectives, which includes delivery of the Do What Matters Plan, monitoring performance against risk appetite and reviewing customer management information that measures the execution of customer conduct strategies. These metrics, together with a wider dashboard of management information, are reviewed and discussed. In addition, the Remuneration Committee reviews achievement against the Primary Corporate Objectives at each meeting to support its decision making on variable remuneration outcomes. In this way, variable remuneration outcomes are directly linked to metrics that support the delivery of TSB's strategic objectives.

As described on page 21, the Do What Matters Plan is TSB's responsible business plan which describes how, through delivery of TSB's purpose and strategy, TSB seeks to contribute to a better society. The five pillars of the Do What Matters Plan focus on supporting the interests of key stakeholder groups, including customers, small businesses, employees and communities, as well as reducing impact on the environment and have been embedded throughout TSB with the Board updated on progress on a monthly basis.

*Customers*
The Board takes account of customer experience through regular reviews of key measures such as NPS and customer conduct metrics. Continuing the focus seen in 2020, a further 'spotlight session' on vulnerable customers was held during 2021, providing a further opportunity for the Board to challenge management's plans to enhance the service being provided to such customers as part of the Money Confidence programme. The Board also held two 'deep dive' sessions on complaints in 2021 to support and challenge management's efforts to improve the customer experience through root cause analysis of the main complaint types and to implement action plans to address the underlying causes identified.

A key and difficult decision that the Board was faced with in 2021 was whether to support the proposal to close a further 70 branches in 2022, announced on 30 November 2021. This proposal took account of the continued migration of customer activity from branch to digital and mobile channels, which started before but was accelerated by the COVID-19 pandemic. Whilst ultimately supporting the proposal, the Board carefully considered the impact of the decision on customers, with a particular emphasis on vulnerable customers, taking account of the residual branch footprint, access to cash and the other channels through which customer service would be maintained. The Board considered the decision across two sessions: i) a pre-Board familiarisation session and ii) a subsequent Board meeting. In both of these sessions, the Board challenged and input into management's plans to mitigate the impact on, and communicate the changes to, customers and employees.

*Businesses*
TSB believes that establishing a close relationship with suppliers (including a clear accountability framework) is a pre-requisite for resilient customer services. The Board approves the outsourcing strategy annually, together with any changes to the boundaries of outsourced critical services. Operational excellence is a critical pillar of TSB's strategic plan and, as part of this, TSB will continue to work more closely with certain key suppliers, having taken direct control in 2020 of key relationships formerly managed by Sabis, the previous supplier of TSB's outsourced IT services.

*Employees*
The Board is proud of the commitment of our employees and the collaborative culture in TSB. The Board operates a framework that takes account of the interests of our employees, including:

- Promoting the role of recognised trade unions in independently representing the interests of employees;
- The appointment of a Board level whistleblowing champion, as more comprehensively referred to on page 38 in the Corporate governance statement;
- Providing challenge, through the auspices of the Remuneration Committee, to ensure that remuneration policy is appropriate for all employees, as well as executives, and provides for competitive remuneration strongly aligned to the delivery of TSB's strategic goals;
- Undertaking semi-annual reviews of talent and succession, particularly in respect of leadership roles within TSB; and
- Considering and interrogating the output from the annual Colleague Experience Survey and additional 'pulse' surveys issued from time to time.

In addition, and alongside the considerations referenced in the Customer section above, the Board challenged management on the impact of the branch closure proposal on affected employees. In this regard, the Board was encouraged by management's intention to re-deploy as many of the impacted staff as possible.

# Section 172 statement (continued)

*Employees (continued)*
The Board also receives a presentation on an annual basis from The Link to facilitate direct engagement between the Board and employees. The Link is a forum for employees across all levels and all parts of TSB with two regional groups (north and south). It gathers and builds on employee feedback and enables meaningful dialogue between employees, the Executive leadership and the Board on a wide range of topics. Throughout 2021, The Link focused on areas such as the Do What Matters Plan, new products and services, employee wellbeing, engagement and responding to COVID-19, including new ways of working. The outputs from every meeting of The Link are presented to the Executive Committee to help inform TSB's decision making.

As explained in the Nomination Committee report on pages 41 and 42, the Board plays an active role in promoting and challenging progress in establishing a truly diverse and inclusive culture at TSB and carries out succession planning reviews to ensure continuity of skilled employees.

*Communities / Environment*
The Board also fully recognises its obligations to consider the interests of the wider communities in which TSB operates and this is demonstrated in its support of the Do What Matters Plan launched in 2020 and detailed on page 21. The Board reviewed and supported the Do What Matters Plan at its inception and receives updates on progress on a monthly basis through the Chief Executive report, as well as a more comprehensive review of progress annually.

TSB's Do What Matters Plan formalises the Bank's commitment to reducing its impact on the environment while helping customers and employees do the same. As part of this plan, we have committed to reduce our environmental impact and deliver against our goals as outlined starting on page 27. In addition, the Board has engaged with the climate change agenda throughout 2021, inputting into management's plans to recognise and mitigate the risks to the business arising from climate change. The majority of this engagement has taken place through regular discussion of the topic at Risk Committee meetings, and was complemented with a Board education session that was jointly hosted by TSB and EY. This session was designed to update on the consolidated activity at TSB regarding climate change risk, together with the regulatory context and requirements, and the progress being made by TSB in its risk management response to these. Further commentary on climate change risk is included in the Risk management section starting on page 18. In addition to the five pillars considered by the Board and addressed through the Do What Matters Plan, the Board also has regard for the interests of the bank's shareholder and regulators as outlined below.

- *TSB's shareholder, Sabadell.* Given Sabadell's 100% ownership of TSB, it is natural that the promotion of the long-term success of TSB, through the development of a clear purpose and strategy, is aligned with the interests of Sabadell. Sabadell's interests are represented at Board by two shareholder appointed Non-executive Directors. Any circumstances where shareholder and TSB interests are not aligned are managed through the disclosure and management of any such potential conflict. Sabadell's interests are further represented through the UK Steering & Coordination Committee as outlined on page 33. During 2021, both the former Chief Executive and the current Interim Chief Executive presented to the Sabadell Board.
- *Regulators.* Open and honest engagement with regulators is a cornerstone principle of the UK regulatory environment. The Chief Risk Officer reports regularly to the Risk Committee and the Board on material matters of regulatory liaison and TSB's assessment of the quality of the relationship with each regulator. Certain Board members maintain a direct relationship with the FCA and PRA through the framework of 'proactive engagement and continuous assessment' meetings and report on key themes discussed through committee and Board meetings, as appropriate.

**Other non-financial disclosures**
TSB has a moral, legal and regulatory duty to prevent, detect and deter financial crime and maintains a financial crime framework. This framework is supported and reinforced by TSB systems and behaviours which put the customer at the heart of every interaction. TSB promotes an environment which is hostile to illicit activity to protect its customers, employees, and communities from financial crime, and continues to invest in further system control enhancements. TSB's compliance with requirements of the financial crime framework is monitored through ongoing control testing, assurance, audit, and the provision of management information at senior governance committees. TSB's Modern Slavery Statement (which is available on our website) sets out the policies we apply and actions we take to ensure that our employees and customers are treated with dignity and respect. This includes raising awareness of issues that could put our customers at risk such as vulnerability and exploitation. The statement also explains how we ensure that TSB's values are applied within our supply chain, including the due diligence we carry out on our suppliers.

Strategic report on pages 2 to 31 approved, by order of the Board.

**Keith Hawkins,**
*Company Secretary,*
*26 January 2022*

# Corporate governance statement

# How the business is managed

The design and operation of a robust corporate governance framework appropriate for a bank of TSB's scale and ambition is critical to meeting the needs of all our stakeholders. TSB's corporate governance framework encompasses TSB Banking Group plc (the Company), TSB Bank plc (the Bank) and other subsidiaries of the Company (together TSB). Each Director of the Company also serves as a Director of the Bank. Nick Prettejohn, who succeeded Richard Meddings on 29 November 2021, is the Chairman of the Boards of both the Company and the Bank. The Board of the Company (the Board), as a whole, is collectively responsible to the shareholder for promoting the long-term success of the Company by directing the Company's affairs. The corporate governance framework is designed to assist the Board, the Board of the Bank and the Chief Executive in discharging their duties by ensuring an appropriate scheme of delegation. This is achieved through:

- Board authorities being delegated from the Boards of the Company and the Bank (together the TSB Boards) to Board committees and to the Chief Executive; and
- Delegated executive authorities through which aspects of the Chief Executive's authority are delegated to other senior executives and which set out the support provided by the executive committees.

TSB's corporate governance structure is supported by the internal control and governance framework as outlined on pages 39 and 40. An important principle, applied throughout the corporate governance framework, is that the delegation of executive authority is to the individual office holders (who may in turn delegate aspects of their authority to others). Executive committees may be established to support the individuals in exercising their delegated authorities, but the committees do not separately hold any delegated authority in their own right. This approach to individual accountability is aligned to the principles of the Senior Managers & Certification Regime.

Whilst the Bank operates as a ring-fenced UK bank, it is also part of a wider group, comprising Banco de Sabadell, S.A. (Sabadell) and its subsidiaries (together the Sabadell Group), and is required to adhere to relevant Sabadell Group policies, in addition to any relevant obligations imposed by Sabadell Group's regulators, the Bank of Spain and the European Central Bank.

To assist with this, Sabadell operates an information sharing and co-ordination committee, the UK Steering & Coordination Committee (UKSCC) which seeks to provide Sabadell with a regular overview of the performance of TSB and to ensure that TSB policies and processes are aligned to those of the Sabadell Group where it is appropriate to do so. Certain members of the Bank's Executive Committee are appointed as members of the UKSCC.

Although the Company does not have shares with a premium listing on the London Stock Exchange, and does not need to comply with the UK Corporate Governance Code (Code), the Board has chosen to voluntarily adopt those principles of the Code that are considered appropriate for TSB as a wholly owned subsidiary of Sabadell and to report against the Code in the annual report. A copy of the Code is available at www.frc.org.uk. The following aspects of the Code are not considered appropriate for TSB:

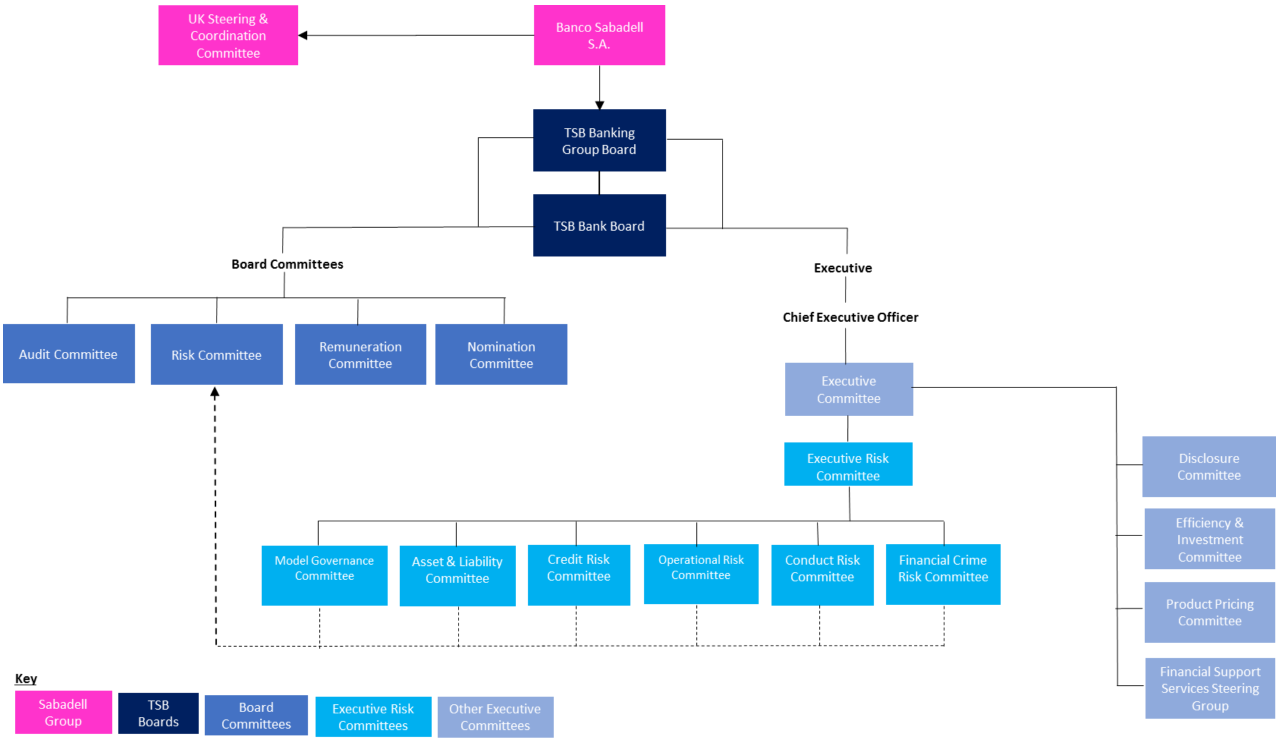
- All Directors should be subject to annual re-election by shareholders (Provision 18);
- Provisions relating to the proportion of Independent Non-executive Directors who are members of the Audit and Remuneration Committees (Provisions 24 and 32); and
- Provisions relating to dialogue with shareholders (Provisions 3 and 4).

In addition, the Remuneration Committee has not created a policy for post-employment shareholding requirements (Provision 36). TSB Executive Directors are already subject to long deferral periods (seven years with a further one year holding period) for Sabadell shares awarded as part of TSB variable remuneration. Therefore, the continuing view is that no specific post-cessation shareholding requirement be introduced for TSB Executive Directors at the present time. The Remuneration Committee continues to keep this under review as part of a regular Committee agenda item to consider market developments.

With regard to the requirement to align pension contribution rates for TSB Executive Directors with those available to the wider TSB workforce (Provision 38), the Remuneration Committee has, as recorded in the 2020 Annual Report & Accounts, considered and agreed to implement an approach to align the contribution rates by 31 December 2022.

# How the business is managed (continued)

The corporate governance framework is reviewed at least annually by the Board to confirm that governance arrangements remain effective. The diagram below sets out the framework of Board and executive committees.




### The role and responsibilities of the Board

The Board's full responsibilities are set out in the matters reserved for the Board. The main items are summarised below.

**(i) Strategy**

- Approving, and monitoring the implementation by management of, TSB's strategy and long-term objectives and ensuring that rigorous and robust processes are in place to monitor organisational compliance with risk appetite and all applicable laws and regulations;
- Determining Board structure, size and composition, and determining the roles and responsibilities of the Chairman, Senior Independent Director, Non-executive Directors, Chief Executive and Executive Directors;
- Approving the high-level framework of Board delegations;
- Approving material TSB contracts and material acquisition or disposal of assets or equity investments by the Company or any subsidiary of the Company; and
- Approving material changes to TSB corporate and organisational structure, including changes to the Company's listing status or its status as a plc.

**(ii) Risk**

- Reviewing the effectiveness of the Company's and Bank's risk management and internal control systems; and
- Approval of the Bank's Risk Appetite, Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), Reverse Stress Test, and Recovery Plan.

**(iii) Shareholder communications**

- Approving the annual report and accounts;
- Approving TSB's dividend policy; and
- Approving the resolutions and associated documentation for the shareholder at a general meeting.

In accordance with the Company's articles of association, Sabadell is empowered to determine that certain matters reserved to the TSB Boards also require approval by Sabadell.

# How the business is managed (continued)

**Role of Directors**

There is a clear division of responsibility between the Chairman and Chief Executive. This has been approved by the Board and is available to view at www.tsb.co.uk/investors/people/.

The role of the Non-executive Directors includes the following key elements:

- Providing constructive challenge to management and helping to develop strategy;
- Scrutinising the performance of management in meeting agreed goals and objectives and monitoring the reporting of performance;
- Satisfying themselves on the integrity of financial information and that financial controls and risk management systems are robust and defensible; and
- Determining appropriate levels of remuneration for Executive Directors and other senior management and having a prime role in appointing and, where necessary, removing Executive Directors and in Board and Executive Committee succession planning.

The Senior Independent Director's role is defined as follows:

- Acting as a sounding board for the Chairman and to serve as an intermediary for the other Directors when necessary;
- Being available to the shareholder if it has concerns which cannot otherwise be resolved;
- Chairing meetings in the absence of the Chairman; and
- Reviewing the Chairman's performance.

**Board membership and composition**

As at the date of this report the Board has eleven members and is comprised as follows:

| | |
|---|---|
| Chairman: | Nick Prettejohn (independent on appointment) |
| Executive Directors: | |
| Interim Chief Executive | Robin Bulloch |
| Chief Financial Officer | Declan Hourican |
| Independent Non-executive Directors: | Adam Banks |
| | Elizabeth Chambers |
| | Lynne Peacock (Senior Independent Director) |
| | Mark Rennison |
| | Andy Simmonds |
| Non-executive Directors: | Alicia Reyes |
| | Tomás Varela |
| | David Vegara |

Biographical details of the Chairman and Executive Directors are included on page 57. Details of the Non-executive Directors, including their skills and experience, can be found at www.tsb.co.uk/investors/people/.

A record of the Directors who have served during the year is shown in the Directors' report on page 49. The letters of appointment for Non-executive Directors are available at the Company's registered office and at the Annual General Meeting.

# How the business is managed (continued)

**Board Committees**

Certain responsibilities of the TSB Boards are delegated to committees of the Board to assist the TSB Boards in carrying out their functions.

- The Risk Committee (chaired by Andy Simmonds) oversees the management of the risks that TSB faces;
- The Audit Committee (chaired by Mark Rennison) oversees financial reporting;
- The Nomination Committee (chaired by Nick Prettejohn) leads the process for appointments to the TSB Boards and succession planning for the TSB Boards and Executive Committee; and
- The Remuneration Committee (chaired by Lynne Peacock) formulates TSB remuneration policy and supports the ongoing delivery of sustainable performance.

The Audit and Nomination Committees have each prepared a report which includes a description of their role and composition. Each of the Board Committees' terms of reference are available at www.tsb.co.uk/investors/people/.

**Meeting attendance**

The table below sets out attendance of Directors at Board meetings and the attendance of Committee members at the relevant Committee meetings held during the year.

| Name of Director (xii) | Board meetings attended | Audit Committee meetings attended | Risk Committee meetings attended | Nomination Committee meetings attended | Remuneration Committee meetings attended |
|---|---|---|---|---|---|
| Nick Prettejohn (i) | 2 out of 2 | – | – | – | – |
| Richard Meddings (ii) | 7 out of 7 | – | – | 3 out of 3 | – |
| Debbie Crosbie (iii) | 7 out of 7 | – | – | – | – |
| Declan Hourican (iv) | 4 out of 4 | – | – | – | – |
| Ralph Coates (v) | 4 out of 4 | – | – | – | – |
| Adam Banks (vi) | 7 out of 7 | – | 4 out of 4 | – | 4 out of 4 |
| Paulina Beato (vii) | 1 out of 1 | – | 2 out of 2 | – | 2 out of 2 |
| Elizabeth Chambers | 8 out of 8 | 5 out of 5 | – | – | 6 out of 6 |
| César González-Bueno (viii) | 2 out of 2 | – | – | 1 out of 1 | 2 out of 2 |
| Lynne Peacock | 8 out of 8 | – | 6 out of 6 | 3 out of 3 | 6 out of 6 |
| Mark Rennison | 7 out of 8 | 5 out of 5 | 6 out of 6 | 2 out of 2 | – |
| Alicia Reyes (ix) | 5 out of 6 | – | – | 1 out of 1 | 3 out of 3 |
| Andy Simmonds | 8 out of 8 | 5 out of 5 | 6 out of 6 | 1 out of 2 | – |
| Tomás Varela | 8 out of 8 | 5 out of 5 | 2 out of 2 | – | – |
| David Vegara | 8 out of 8 | – | 6 out of 6 | – | – |
| Polly Williams (x) | 1 out of 1 | 1 out of 1 | 1 out of 1 | – | 1 out of 1 |

(i) Appointed to the Board on 1 November 2021.
(ii) Resigned from the Board on 29 November 2021.
(iii) Resigned from the Board on 2 December 2021.
(iv) Appointed to the Board on 13 September 2021.
(v) Resigned from the Board on 13 September 2021.
(vi) Appointed to the Board on 8 February 2021.
(vii) Resigned from the Board on 21 March 2021.
(viii) Resigned from the Board on 18 May 2021.
(ix) Appointed to the Board on 18 May 2021.
(x) Resigned from the Board on 5 March 2021.
(xi) Robin Bulloch is not shown in the above table as he joined the Board after the last Board meeting of the year.
(xii) Directors not able to attend meetings due to longstanding prior commitments, illness or unavoidable circumstances, provided comments to the chair concerned on matters to be discussed at the relevant meeting.

**Board changes and development**

During the year, Adam Banks, Alicia Reyes and Nick Prettejohn completed a comprehensive induction programme following their appointment to the Board as Non-executive Directors, on 8 February 2021, 18 May 2021 and 1 November 2021, respectively, whilst Declan Hourican completed a comprehensive induction programme after succeeding Ralph Coates, effective from 13 September 2021, as the Chief Financial Officer and an Executive Director of TSB.

Robin Bulloch became the Interim Chief Executive, subject to regulatory approval, on 3 December 2021, replacing Debbie Crosbie, who resigned from this role and as an Executive Director on the TSB Boards on 2 December 2021. Robin Bulloch was subsequently appointed, following TSB and Sabadell Board approval, as an Executive Director on the TSB Boards on 16 December 2021. A development plan has been established for Robin Bulloch, the majority of which will be completed by the end of February 2022, to support his transition to the role of Interim Chief Executive.

# How the business is managed (continued)

**Board changes and development (continued)**
Alicia Reyes replaced César González-Bueno, effective 18 May 2021, as a Director appointed at the nomination of Sabadell, whilst Nick Prettejohn succeeded Richard Meddings, with effect from 29 November 2021, as the Chairman of TSB. Polly Williams and Paulina Beato resigned from the Board as Non-executive Directors on 5 March 2021 and 21 March 2021, respectively.

Directors are given the opportunity to undertake further training in order that they are fully comfortable with their role within the Board and to enable them to contribute to the operation of the Board and the long-term success of the Company in the fullest manner possible.

Board education sessions are also regularly held to allow Non-executive Directors to explore key strategic and risk issues outside of the time constraints of a formal Board meeting. During 2021, a number of education sessions were run, reflecting a return to the normal frequency of such sessions following a reduction in 2020 due to management and Board focus on the Bank's response to COVID-19. In 2021, sessions were held on technology transformation, climate change risk, oversight of key suppliers, the requirements of the UK Operational Resilience regulations, and marketing and social media, whilst TSB's Chief Economist provided an update on UK economic projections at the start of the year. In addition, during the year, the members of the Remuneration Committee attended an education session, hosted by external remuneration advisers PwC, detailing regulatory expectations of remuneration committees, current areas of regulatory focus and current remuneration trends in the banking industry.

**Board effectiveness**
The 2021 effectiveness review, covering the Board as well as the Audit, Risk and Remuneration committees, was externally facilitated, in line with the recommendation of the UK Corporate Governance Code that relevant companies undertake an externally facilitated review once every three years (TSB's last externally facilitated review having taken place in 2018).

A tender process was undertaken, facilitated by the Company Secretary and overseen by the Board Chair and Senior Independent Director, resulting in submissions from four potential external reviewers. Following careful consideration and in accordance with the Principles of Good Practice, published by the Chartered Governance Institute UK & Ireland (CGI) in January 2021, the appointment of Clare Chalmers Limited was approved by the Board in May 2021. Clare Chalmers Limited was selected on the basis of the firm's solid experience of undertaking effectiveness reviews for financial services firms and UK subsidiary boards, as well as displaying a clear understanding of the review brief provided. It is noted that Clare Chalmers Limited has no other commercial relationship with TSB or its Board members, was undertaking its first Board effectiveness review for TSB, satisfies the principles of the CGI's Code of Practice for Board Reviewers, and intends to be a signatory of this Code when the process for signing up becomes available.

In accordance with the Principles of Good Practice, the objectives, scope and process of the review were agreed by the Board Chair, the Senior Independent Director and Clare Chalmers Limited, and set out in an engagement letter. The process (for which support, as required, was provided to Clare Chalmers Limited by the TSB Company Secretariat) consisted of a review of Board and committee papers and other relevant materials, meeting observations of each of the Board and Audit, Risk and Remuneration committees, and one-to-one interviews of 19 participants, including all Board members in office during the period of review (July and August 2021), key members of the Executive Committee who regularly attend Board and Board committee meetings, and the Company Secretary. The scope provided for a comprehensive review of a wide range of themes typically covered in a Board evaluation as set out in the review brief, with particular focus on a number of key areas proposed by the Board Chair and Senior Independent Director. Individual performance of key Board positions (such as the Board Chair, Senior Independent Director and Board committees' chairs) was also considered as part of the review.

The final report produced by Clare Chalmers Limited was provided to the Board and the key findings presented and discussed at the Board meeting held on 22 November 2021. The exercise revealed that the TSB Board continues to be effective, with a number of areas working well. The general view was that the mix of skills, knowledge and expertise of Board members remains satisfactory, noting that Board composition has been substantially refreshed over the previous two years.

Whilst the good gender balance on the Board at the time of the review was noted, one review finding, relating to possible enhancement of ethnic diversity in the Board composition, had been previously recognised by the Board and is being further considered as part of the Bank's commitment to the Confederation of British Industry's Change the Race Ratio Charter. Other themes from the report included the productive relationships between the Non-executive Directors and the Executive team, and a cohesive and open atmosphere in meetings.

# How the business is managed (continued)

**Board effectiveness (continued)**
The main area for improvement identified in the report related to finding the right balance between keeping Board and Risk Committee meeting discussions high level and strategic versus discussion at a more detailed level, when required. The recently appointed Chairman will reflect on the findings of the report with the Interim Chief Executive to determine which of its suggestions should be taken forward. Addressing actions agreed in response to the 2020 internal effectiveness review, 'deep dive' sessions took place during 2021 on the topics of social media and oversight of key suppliers, and a further discussion on the Bank's longer-term business plans will take place as part of the strategy refresh scheduled for the first half of 2022.

The above sections have been reviewed and agreed with Clare Chalmers Limited.

The scope of the above review did not cover the Nomination committee, which conducted its own review of effectiveness, on a lighter touch basis, concluding that the committee had fulfilled the scope of its responsibilities during 2021. Whilst no actions were deemed necessary to further enhance the performance of the Nomination committee at this time, it was agreed that this would be kept under review, particularly following the recent change of committee chair.

**Independence**
The Board has considered whether there are any relationships or circumstances which could appear to affect the Independent Non-executive Directors' judgement. No Independent Non-executive Director, or member of their immediate family, has ever had a material relationship with TSB nor receives additional remuneration apart from Director fees. The Independent Non-executive Directors do not participate in TSB's pension or share schemes. No Independent Non-executive Directors serve as Directors of any companies or affiliates in which any other Director is also a Director.

Alicia Reyes is a Non-executive Director on the Sabadell Board and David Vegara is Sabadell's Chief Risk Officer and a member of both Sabadell's Management Committee (Comité de Dirección) and the Sabadell Board, and for these reasons are not considered to be independent. Tomás Varela was Sabadell's Chief Financial Officer and a member of Sabadell's Management Committee until 3 March 2021, so is also not considered to be independent. Since stepping down from these roles, he has received fees from TSB commensurate with his TSB Boards and Board committee appointments, whilst Alicia Reyes has also, since her appointment to the TSB Boards on 18 May 2021, received fees from TSB commensurate with her TSB Boards and Board committee appointments. David Vegara does not receive any fees from TSB. César González-Bueno, who served on the TSB Boards from 23 March 2020 until 18 May 2021, was not considered to be independent as he was appointed at the nomination of Sabadell. César González-Bueno was paid TSB Director fees in line with those paid to the Independent Non-executive Directors until 18 December 2020, following his appointment as Sabadell's Chief Executive Officer.

**Management of conflicts of interest**
Each Director has a duty under the Companies Act 2006 to avoid a situation in which they have, or may have, a direct or indirect interest that conflicts, or might conflict, with the interests of the Company. This duty is in addition to the existing duty that Directors owe to the Company to disclose to the Board any interest in a transaction or arrangement under consideration by the Company. If Directors become aware of any situation which may give rise to a conflict of interest they must inform the rest of the Board immediately and the Board is then permitted under the articles of association to authorise such conflict if appropriate. This information is recorded in the Company's register of conflicts together with the date on which authorisation was given. In addition, Directors are asked to certify, on a bi-annual basis, that the information contained in the register is correct.

Save as described as follows in relation to David Vegara, Tomás Varela and Alicia Reyes, there are no conflicts of interest between any duties owed by the Directors to the Company and their private interests or other duties. As an Executive/Director, former Executive, and Non-executive Director of Sabadell, respectively, David Vegara, Tomás Varela, and Alicia Reyes will have a conflict of interest in circumstances where the interests of TSB and the wider Sabadell Group are not, or may not be, aligned. This conflict has been authorised by the Board.

**Whistleblowing arrangements**
TSB has a robust whistleblowing process in place which is available to all employees and contractors, who are able to raise concerns anonymously via TSB's whistleblowing hotline or via the independent whistleblowing charity, Protect. The Board oversees the adequacy of TSB's whistleblowing arrangements, ensuring that they are proportionate and enable employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. In the role as TSB's Whistleblowing Champion, Mark Rennison (Chair of the Audit Committee from 25 February 2021), and his predecessor Polly Williams (Chair of the Audit Committee until 25 February 2021), received regular reports from management which provided details of whistleblowing matters. The Board receives an annual report from management providing an overview of whistleblowing procedures and outcomes, and challenges management on TSB's plans to ensure whistleblowing policies and processes are aligned with external best practice. As part of its annual review of whistleblowing matters, the Board was satisfied that there were no material concerns raised relating to TSB's whistleblowing processes or outcomes in 2021.

# How the business is managed (continued)

**Reappointment of Directors**

The Board considers that all Directors continue to be effective, committed to their roles and have sufficient time available to perform their duties. All Non-executive Directors, with the exception of David Vegara, Tomás Varela and Alicia Reyes (being Directors appointed at the nomination of Sabadell), have been appointed for an initial three year term and their continued appointment thereafter is considered by the Board at the end of the initial period of office. As the Company is a wholly owned subsidiary of Sabadell it is not considered necessary for Directors to seek annual re-election or for the Directors appointed at the nomination of Sabadell to be appointed for a specified term.

In accordance with Provision 15 of the Code, Directors are required to seek prior approval from the Board before taking up additional external appointments. Three significant additional appointments were taken up by Directors during the financial year following pre-approval by the Board: i) Lynne Peacock was appointed as the Senior Independent Director of Serco, ii) Mark Rennison was appointed as the Chair of Royal London's Risk & Capital Committee (following his appointment in 2020 to the Board of Royal London as a Non-executive Director and serving as a member of their Audit, Risk & Capital and Nomination Committees), and iii) Debbie Crosbie was appointed as a Non-executive Director of SSE plc. In addition, the Board approved the appointment of Tomás Varela as a Non-executive Director of Julius Baer and a member of its Audit Committee, to take effect following confirmation of the appointment at the 2022 Annual General Meeting of that company.

**Company Secretary and independent professional advice**

Keith Hawkins has served as the Company Secretary throughout the year ended 31 December 2021. The Company Secretary is responsible to the Board for ensuring compliance with corporate governance requirements. The Board has access to the Company Secretary individually and collectively. As well as the support of the Company Secretary, any Director may take independent professional advice at the Company's expense in the furtherance of their duties, where considered necessary.

**Evaluation of internal controls procedures**

The Board has carried out an assessment of the effectiveness of the Company's risk management and internal control systems. The Audit Committee report explains the process in more detail on page 47.

**External auditor**

KPMG have expressed their willingness to continue as the Company Auditors. As outlined in the Audit Committee report on page 48, resolutions proposing the re-appointment of KPMG for the 2022 audit, and to authorise the Directors to determine their remuneration, will be proposed at the 2022 Annual General Meeting, as recommended by the Audit Committee and approved by the Board.

**Principal accountant fees and services**

An analysis of fees for professional services provided by KPMG, the Company's external auditor for the year ended 31 December 2021, is set out in note 14 to TSB's consolidated financial statements on page 84.

**Internal control and governance framework**

An explanation of TSB's Executive Committee and its sub-committees is set out below.

**(i) Executive Committee**

Chaired by the Interim Chief Executive, TSB's Executive Committee is TSB's principal executive committee and collectively supports the Interim Chief Executive in developing and implementing TSB's strategy, monitoring business performance, and agreeing any actions that are required to manage issues that affect TSB. Consideration is given to the interests of all stakeholders.

All members of the Executive Committee report to the Interim Chief Executive. In addition, the Chief Risk Officer has a reporting line to the Chair of the Risk Committee. To protect the independence of Internal Audit, the Chief Audit Officer's primary reporting line is to the Chair of the Audit Committee with a secondary reporting line to the Interim Chief Executive. The Chief Audit Officer also has a reporting line to the Sabadell Group Chief Audit Officer.

# How the business is managed (continued)

**Internal control and governance framework (continued)**

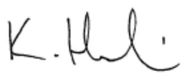
**(ii) Executive Risk Committees**
The role of the Executive Risk Committee, which is chaired by the Interim Chief Executive, is to ensure an enterprise wide perspective of TSB's risks and determine strategic actions to address them.

The six further committees in the executive layer of risk governance (Asset & Liability Committee, Credit Risk Committee, Operational Risk Committee, Conduct Risk Committee, Financial Crime Risk Committee and Model Governance Committee), which each report into the Executive Risk Committee (and indirectly to the Board Risk Committee), monitor and challenge risk exposures against approved risk appetite and are structured to align with the risk management framework described on page 13. Each risk committee within the governance structure is responsible for ensuring an appropriate risk and control environment is maintained within its area of authority. This enables day-to-day decisions to be made, with clear reporting lines established through the Executive Risk Committee, Executive Committee and Board Risk Committee, and ultimately to the Board. Each of the six executive risk committees is chaired by an Executive Committee member. Further detail on the responsibilities of each of the executive risk committees is shown in the Risk governance section on page 14.

**(iii) Other Executive Committee Sub-Committees**
The following other executive committees report into the Executive Committee:

- The Product Pricing Committee which is responsible for reviewing and approving pricing strategy and any decisions in relation to the pricing of TSB's products;
- The Disclosure Committee which is responsible for identifying inside information and determining how and when TSB should disclose that information in accordance with its obligations to the Sabadell Group and holders of TSB's listed debt;
- The Efficiency & Investment Committee which is responsible for managing cost in the business and monitoring delivery of operating expenses in the Medium Term Plan, for ensuring investment is aligned to strategic priorities and to track the progress of the investment portfolio, and to approve business cases for funding; and
- The Financial Support Services (FSS) Steering Group, which provides strategic oversight, advice and decisioning to support the Bank's on-going enhancement of its FSS function.

By order of the Board



**Keith Hawkins**
*Company Secretary*
*26 January 2022*

# Nomination Committee report

**Chairman's introduction**
The Committee is authorised by the Board to keep the structure, size and composition of the TSB Boards under review and to make recommendations to the Board with regard to any changes required. It leads the process for appointments to the TSB Boards, Board committees and the chairmanship of those committees and also considers succession planning for the TSB Boards and Executive, taking into account the skills, knowledge, experience, diversity and leadership needs of TSB.

As at the date of this report, the members of the Nomination Committee are Nick Prettejohn (Chair), Lynne Peacock, Andy Simmonds, Mark Rennison and Alicia Reyes. Andy Simmonds and Mark Rennison were appointed as members of the Committee on 23 March 2021, whilst Alicia Reyes was appointed as the Sabadell representative on the Committee on 27 July 2021, replacing César González-Bueno, who resigned from the Board on 18 May 2021 following taking up the role of Chief Executive Officer of Sabadell. Nick Prettejohn replaced Richard Meddings as a member and Chair of the Committee with effect from the date of his regulatory approval to act as Board and Nomination Committee Chair on 29 November 2021.

**Appointment of directors and succession planning**
The Committee met three times formally during 2021. The key matters discussed and agreed at these meetings were:

- Consideration of Board committee composition in response to the changes to the Board made through the first half of 2021, to ensure that an appropriate balance of skills and experience was maintained across the committees. Following Committee recommendation and subsequent Board approval:
  - Adam Banks joined the Risk and Remuneration Committees and Mark Rennison and Andy Simmonds joined the Nomination Committee, all with effect from 23 March 2021. Following the additions to the Nomination Committee, each of the Board committee chairs is a member of that committee; and
  - Alicia Reyes, having been appointed by Sabadell as one of their nominated directors on the TSB Board on 18 May 2021 in place of César González-Bueno, joined the Remuneration and Nomination Committees on 27 July 2021, replicating the committee membership previously held by César González-Bueno.
- Consideration, and recommendation to the Board, of the appointment of Nick Prettejohn as an Independent Non-executive Director and, subsequently, as successor to Richard Meddings as Board Chair. This followed an extensive search by Egon Zehnder (who have no other connection with TSB), which covered a broad range of candidates, and a series of interviews with executives and non-executives across TSB and Sabadell. The Board subsequently approved the appointment, with Nick Prettejohn joining the Board on 1 November 2021 and taking over from Richard Meddings as Chair of the Board and Nomination Committee on 29 November 2021 following the receipt of regulatory approval; and
- Review of the updated Non-executive Director skills matrix, which the Committee reviews periodically. This review determined that, following the various Board changes across 2020 and 2021, there remained a good balance of skills and experience across the Board, with some overall strengthening since the matrix was last updated in 2019.

In addition to the matters outlined above, the Committee also recommended to the Board, by written resolution passed on 7 May 2021, the appointment of Declan Hourican as successor to Ralph Coates as TSB's Chief Financial Officer. This followed an extensive search by Odgers Berndston (who have no other connection with TSB) and interviews with executives and non-executives across TSB and Sabadell. Following subsequent Board and regulatory approval, Declan Hourican was appointed as an Executive Director and Chief Financial Officer of TSB on 13 September 2021 (with Ralph Coates resigning from these positions on the same date).

Robin Bulloch was appointed Interim Chief Executive by the Executive Committee, effective 3 December 2021, following the resignation of Debbie Crosbie. The appointment was endorsed by the TSB Board, which also provided approval for the appointment of Robin Bulloch as an Executive Director on the TSB Board. The appointment as an Executive Director became effective on 16 December 2021, following Sabadell Board approval. The Nomination Committee will be engaged in 2022 in the consideration of Debbie Crosbie's permanent replacement as TSB Chief Executive.

**Executive Succession Planning**
At its meetings held in July and November 2021, the Committee considered the Executive succession plan presented by TSB's HR Director, which covered the Executive Committee, together with the layer of senior management reporting into Executive Committee members. This continued the practice, started in 2020, to include bi-annual formal consideration of Executive succession planning in the Committee meeting calendar.

# Nomination Committee report (continued)

**Diversity and inclusion**
TSB is committed to fair and consistent treatment of all employees regardless of their personal characteristics, which include gender, ethnicity, religion, sexual orientation, transgender status, disability, nationality or age. The Board has adopted this approach to diversity and had regard to it during the appointment processes discussed above. The Being a responsible business section, on page 24, provides further detail on TSB's approach to diversity and inclusion. A key aspect of this is TSB's Do What Matters Plan, which was published in 2020 and includes a new framework to support TSB's existing ambition to create a truly inclusive workplace. The Board promotes and affirms TSB's aspiration to meet and exceed the target of 33% of Board positions being held by women, as set out in the Hampton-Alexander Review. As at 31 December 2021, 27% of the Board are women. Until Debbie Crosbie's resignation from the Board on 2 December 2021 this had been 36%.

**The Chairman's other significant commitments**
My other significant commitments, in addition to the role of TSB Chairman, are as Chairman at the media group, Reach plc, and the human rights charity, Prisoners Abroad.

Details of my other external appointments are included on page 57 and at www.tsb.co.uk/investors/people/.

N. Prettejohn

**Nick Prettejohn**
*Chairman, Nomination Committee*
*26 January 2022*

# Audit Committee report

**Chairman's introduction**

I am pleased to report, for the first time since assuming the role of Chair of the Audit Committee, on how the Committee has discharged its responsibilities during what continue to be very challenging times. I assumed the role of Chair of the Committee on 25 February 2021, following a comprehensive handover of responsibilities from Polly Williams. I would like to take the opportunity to thank Polly for her support during this handover and for her excellent work in chairing the Committee. I fully support our established practice of including a report on the Audit Committee's activities in the Annual Report on a voluntary basis. This reflects the importance of the Committee and the transparent and straightforward manner in which it conducts its activities.

I am a chartered accountant and joined the TSB Board in August 2020. Prior to this I was Chief Financial Officer at Nationwide for 12 years and, prior to that, a former financial services partner at PwC. As well as my TSB Board role, I am a Non-executive Director of Royal London and Homes England.

I have been a member of the Committee throughout 2021 and, since assuming the role of Chair, have been ably supported by my fellow Non-executive Directors, Elizabeth Chambers, Andy Simmonds and Tomás Varela, who have served as members of the Committee throughout the year and bring strong and relevant industry experience. Biographies of the members of the Committee can be found at www.tsb.co.uk/investors/people/. All Non-executive Directors, including the Chairman, of TSB have a standing invitation to attend meetings of the Committee.

As expected, and as discussed in the Committee's report on 2020, the Committee's attention in 2021 was targeted at:

- challenging management's accounting judgements in respect of COVID-19 impacts particularly in relation to estimation of expected credit losses under IFRS 9. Key judgements included:
  - The determination of appropriate future economic scenarios and associated probability weightings;
  - The impact of government support schemes on customer behaviour and associated credit risk; and
  - The extent of additional overlays to take account of repayment risks not fully captured by IFRS 9 models designed and implemented in a pre-pandemic environment.

  As well as ensuring that judgements were evidence based, the Committee reviewed the consistency of the Bank's approach with wider industry practice and trends.

- reviewing the judgements in respect of costs arising from restructuring of the Bank's operations in line with our strategy of simplification and efficiency, including provisions for branch closures;

- Monitoring progress and findings from the ongoing review of past treatment of customers in arrears to ensure that the amounts provided for customer redress remained appropriate and in line with management's proposed remediation strategy and expectations. Further information on this matter is disclosed in note 29 on page110; and

- Monitoring the ongoing strengthening of the Bank's internal control systems and its first line assurance framework over internal controls and risk management processes. A particular focus in this regard was the implementation and embedding of controls over IT operations transferred from Sabis during 2020 and 2021. The Committee was pleased to see significant progress in this area during the year but further improvement is required and it will remain a key item on the Committee's agenda for 2022.

The Committee also received a report from management to assess TSB's position in respect of the PRA's expectations, as outlined in their Dear CEO letter in September, for firms to apply the same levels of governance and control to regulatory reporting as they do to financial reporting.

Effective external audit remains central to the Bank's financial reporting process. The Committee continues to review and challenge the approach to the external audit to take account of learnings from KPMG's first audit in 2020 and, in light of continued improvements in the control environment, to deploy a strategy with increased reliance on controls. The Committee also noted the outcomes from the Financial Reporting Council's Audit Quality Review inspection reports and received reports from KPMG on the steps taken by KPMG to address the findings, as they applied to the TSB audit.

In 2022, I expect the Committee's attention will continue to focus on management's approach and judgements in the key areas of provisions for expected credit losses, continued simplification of the Bank's operations, and further enhancement and embedding of controls and the associated first line assurance framework. I also expect the Committee to challenge management over its preparations to address recommendations arising from the UK Government's consultations to 'Restore Trust in Corporate Governance and Audit'.

**Mark Rennison**
*Chairman, Audit Committee*
*26 January 2022*

# Audit Committee report (continued)

**Membership and operation of the Committee**

The Committee currently comprises three Independent Non-executive Directors (Elizabeth Chambers, Mark Rennison and Andy Simmonds) and one Non-executive Director (Tomás Varela), each with recent, relevant experience in finance or banking. Andy and Mark are also currently members of the Risk Committee.

Committee meetings are attended by members of the Executive Committee including the Chief Executive, Chief Financial Officer, Chief Risk Officer and Chief Audit Officer. The external auditor, KPMG, attends each meeting of the Committee which typically includes a private session with the Non-executive Directors without the presence of executives. A private session with the Chief Audit Officer is also held at least once a year.

The Chair reports to the Board after each Committee meeting on the main matters discussed so that all Directors are informed on the activity of the Committee. The Chair is available to all Directors for discussion of any matters in more detail and maintains regular dialogue outside Committee meetings with members of the Executive Committee, particularly the Chief Executive, Chief Financial Officer, Chief Risk Officer and Chief Audit Officer, and also with the lead partner of the external auditor.

The Committee met five times during 2021.

**Audit Committee responsibilities and activity in 2021**

The Committee is responsible for, amongst other things, the monitoring of the integrity of the financial statements of TSB and the involvement of the external auditor in that process as well as championing a straightforward and transparent culture to ensure that TSB operates within the Board approved risk appetite in respect of financial reporting and internal control. Specifically, the Audit Committee is responsible for reviewing and reporting to the Board on:

- Financial statements and related financial reporting;
- Systems of internal control over financial reporting, business operations and risk management processes;
- Performance and effectiveness of the Internal Audit function; and
- Effectiveness of the relationship with, and work of, the external auditor.

**Financial statements and related financial reporting**

The Committee is responsible for the review and challenge of TSB's half year and annual financial information, including the significant financial reporting estimates and judgements which they contain. During 2021, the Committee has considered the following matters:

**(i) The consistency and appropriateness of, and any changes to, significant accounting policies**

The Committee has considered and accepted management's review of TSB's accounting policies. There have been no material changes in 2021.

**(ii) The methods used to account for significant transactions**

The Committee has reviewed and supported proposals from management on the accounting for:

- The costs of restructuring the Bank; and
- The estimated costs arising from the treatment of some customers in arrears.

**(iii) Viability and going concern assessments in uncertain macroeconomic circumstances**

The Committee has considered management's approach to, and the conclusions of, the assessment of TSB's ability to remain a going concern, taking into account the Bank's capital and liquidity position. The Committee considered and, after taking the Bank's strategy and external market developments into account, supported management's conclusion that it remained appropriate to adopt the going concern basis in preparing the consolidated financial statements. The Committee also considered management's approach to, and the conclusions of, the assessment of TSB's viability. The Committee challenged management's viability assessment period, noting it was over the three years to December 2024. After consideration, the Committee supported the approach adopted by management as described on pages 50 and 51.

**(iv) Review of annual report – fair, balanced and understandable**

The Committee considered management's approach to, and governance arrangements over, the preparation of this annual report and recommended to the Board that, taken as a whole, it was considered to be fair, balanced and understandable. The approach and results of the assessment are set out in the Directors' report on page 52.

# Audit Committee report (continued)

**(v) Whether TSB has made appropriate accounting estimates and judgements**

The Committee has assessed the basis for, and appropriateness of, estimates and judgements proposed by management in the financial statements as presented below. After challenge, the Committee supported management's proposals.

| Accounting estimate / judgement | Audit Committee considerations | Reference |
|---|---|---|
| **Allowance for credit impairment losses** | At December 2021, expected credit losses were reflected in an allowance for credit impairment losses of £189.6 million (2020: £239.0 million) and a provision for off balance sheet commitments of £16.7 million (2020: £19.2 million).<br><br>During 2021, the Committee reviewed regular reports from management assessing the adequacy of the allowance for credit impairment losses. These reports assessed the adequacy of historic provisions against subsequent recoveries, reviewed management's governance arrangements over provisioning adequacy and in particular the governance over impairment models and benchmarked TSB's metrics against other banks.<br><br>*Economic scenarios and associated weightings*<br>The Committee received regular reports from management that assessed the appropriateness of the scenarios and probability weightings throughout the year in light of the evolving economic environment, particularly taking into account the impact of economic support measures by the Government and the effect of the COVID-19 vaccination programme. The Committee challenged management over their scenarios and probability weightings, including how management had assessed emerging risks including from higher inflation and from potential new COVID-19 variants, particularly in relation to the practical impact on unemployment and house prices.<br><br>The Committee noted that during 2021, management had introduced an additional 'high interest rate' severe downside scenario, increasing the number of scenarios used from four to five. This scenario, consistent with the severe but plausible scenarios used in the 2021 ICAAP process, reflected management's judgement that while a severe downside scenario remained a tail risk, the possibility of a significantly higher interest rate environment was heightened relative to last year, particularly in the light of recent inflation data.<br><br>Management presented analysis of the sensitivity of the allowance for credit impairment losses to alternative scenario weightings and concluded that the impact was limited. Management also presented proposals for the disclosures of those sensitivities, set out on page 77, to provide context to their impact. After substantial debate and challenge, the Committee supported management's proposals.<br><br>*Expert credit judgements*<br>At 31 December 2021, the impairment provisions included £61.8 million (2020: £41.2 million) of management's adjustments to modelled outcomes. A key focus of the Committee during the year was an assessment of the level and rationale for such adjustments. The Committee challenged reports prepared by management to support these adjustments, and management's plans to amend, where appropriate, the relevant models to minimise future adjustments.<br><br>*Significant increase in credit risk*<br>The threshold used to determine when there has been a significant increase in credit risk is a key judgement. This determines when a loan moves from stage 1 to stage 2, requiring expected credit loss to be measured using a lifetime expected loss. The Committee received a report from management that assessed the appropriateness of the thresholds used including portfolio performance measures and benchmarking analysis. The Committee was satisfied that the thresholds remained appropriate.<br><br>*Disclosures*<br>The Committee received a report from management summarising enhancements made in 2021 to disclosures regarding expected credit losses which further aligned with the recommendations of the Taskforce on Disclosures about Expected Credit Losses. The Committee was satisfied that the disclosures pertaining to key management judgements set out in note 8 on page 74 and in respect of credit quality in note 18 on page 88 were appropriate.<br><br>The Committee concluded that a robust governance framework existed to monitor provisioning adequacy and that the assumptions and judgements applied by management were appropriate. The Committee was satisfied that the allowance and related disclosures in the financial statements were appropriate. | Note 8 *'Allowance for credit impairment losses'* Page 74 |

# Audit Committee report (continued)

### (v) Whether TSB has made appropriate accounting estimates and judgements (continued)

| Accounting estimate / judgement | Audit Committee considerations | Reference |
|---|---|---|
| **Customer remediation provisions** | At 31 December 2021, TSB carried a provision of £59.5 million (2020: £66.1 million) for estimated costs of alleged misconduct to its customers. This was primarily in respect of estimated charges relating to the treatment of some customers in arrears and who were being serviced by TSB's collections and recoveries department, for which a provision of £54.3 million was carried at 31 December 2021 (2020: £55.0 million).<br><br>During 2021, management continued to analyse the various cohorts of customers potentially impacted and completed detailed account level data analysis that informed a likely range of potential rectification costs, including compensatory interest. While this resulted in a revision to the range of potential costs, it remains consistent with prior year, at between £49.4 million and £56.6 million (2020: between £53.1 million and £57.4 million) with the provision remaining within this range.<br><br>The Committee noted that the customer rectification strategies had been refined following consultations with the skilled person appointed by the FCA and that as a result the depth of the analysis had advanced during the year such that the level of judgement had reduced. The Committee challenged management on the areas of remaining judgement. The Committee agreed with management that the analysis of the data would continue to be refined and that the customer treatment strategy had not yet been finalised by management or the regulator. The Committee was satisfied that the provisions and related disclosures in the financial statements were appropriate. | Note 29 *'Provisions'* Page 110 |
| **Assessment of exposure to the outcome of regulatory investigations** | During 2018 the FCA and PRA commenced a formal joint investigation in connection with the handling of the 2018 migration of data and IT systems. Further, during 2020, the FCA commenced an investigation in to conduct related matters in TSB's collections and recoveries function. Whilst the costs of remediating customers have been recognised in the financial statements, both of these investigations are ongoing, and it is not yet possible to determine the outcome of the regulatory process including any potential fine. The Committee agreed with management's assessment, which included the consideration of industry wide practice in similar circumstances, and the disclosure as a contingent liability included in the financial statements. | Note 23 *'Contingent liabilities'* Page 107 |
| **Restructuring provisions** | At 31 December 2021, TSB carried provisions of £23.2 million (2020: £67.8 million) in respect of estimated costs to restructure the Bank as part of TSB's strategy. This included the estimated costs of the closure of 70 branches that were announced in November 2021 and the residual costs in respect of earlier phases of branch closures announced in 2019 and 2020. The Committee reviewed reports from management setting out the approach and assumptions used which were grounded in experience gained from previous branch closures and supporting evidence from property advisors. The Committee was satisfied that the provisions and related disclosures in the financial statements were appropriate in the light of recent experience. | Note 29 *'Provisions'* Page 110 |
| **Recoverability of deferred tax assets** | At 31 December 2021, deferred tax assets of £123.3 million (2020: £145.2 million) primarily reflected carried forward tax losses and temporary differences arising from the implementation of IFRS 9 in 2018. Continued recognition of this asset requires judgement in assessing the availability of future taxable profits to absorb these carried forward losses and temporary differences. The Committee considered reports from management, including sensitivity analysis, which concluded that on the basis of forecast profits, the asset was recoverable over a period of four years (2020: seven years) which was within the period covered by the medium term plan. A number of sensitivities were considered, including execution risks associated with the Bank's strategy, which could result in a potential one year extension to the estimated recovery period. The Committee agreed with management's judgement that, based on TSB's forecast taxable profits and the associated sensitivity analysis, the deferred tax asset should continue to be recognised in full. | Note 17 *'Deferred tax assets'* Page 85 |
| **Impairment assessment of the Company's investment in TSB Bank plc** | At December 2021, the Company carried an investment in TSB Bank plc of £1,589.4 million (2020: £1,589.4 million). The Committee considered reports from management which concluded that the recoverable amount of the investment, based on value in use, exceeded the carrying value of the investment. These reports assessed the sensitivity of the valuation to alternative forecast profits and discount rates. The Committee agreed with management's judgement that, based on TSB Bank's forecast profits and the associated sensitivity analysis, no impairment was required. | Note 4(ii) *'Investment in subsidiaries'* Page 116 |

# Audit Committee report (continued)

**Risk management and internal control systems**
The Committee is responsible for reviewing the adequacy and effectiveness of TSB's risk management and internal control systems and reporting on that review. In respect of 2021, the Committee took account of the following inputs into its review:

- Regular reports from management on steps taken to embed the risk management framework and key focus areas across the control environment, including a more comprehensive assessment taking risk and control performance in aggregate, increased focus on thematic findings and further prioritisation of critical controls over those that are more procedural;
- Progress against management's plans to continue to strengthen and embed the control environment over IT operations and risks following the transition of IT services from Sabis;
- Ongoing monitoring reports on the effectiveness of TSB's risk management and internal control systems;
- Quarterly reports from management which concluded that assurance over TSB's internal financial control framework has adequate coverage and confirms that controls are generally operating effectively;
- An unqualified Service Organisation Control (SOC) 1 Type 2 report in respect of outsourced credit and debit card operations; and
- Regular management information on the activities of Internal Audit and its report on internal controls.

The Committee was satisfied that TSB's risk and control frameworks are generally effective in identifying, managing and mitigating key risks. Procedures for managing and controlling exposure to financial crime and fraud were strengthened during the year with investment in systems and processes to reflect the evolving nature of these risks. In addition, significant work has been undertaken to improve support for customers in financial difficulty and to integrate controls over IT operations following the transfer from Sabis. However, the Committee concluded that further improvements are required in relation to deficiencies in certain elements of the IT control environment, and embedding of the improvements to financial crime controls and processes in support of customers in financial difficulty. The Audit and Risk committees will continue to monitor progress in this regard. The Committee also noted the importance of continued focus on maturing and automating risk and control frameworks more generally in line with the Bank's strategy of simplification and operational excellence.

The key elements of the management of risk within the business and the effective system for internal controls are set out within the corporate governance statement (see pages 39 to 40).

**Performance and effectiveness of the Internal Audit function**
The Committee is responsible for monitoring the performance and effectiveness of Internal Audit. During 2021, the Committee carried out this responsibility by:

- Approving the Internal Audit Plan, taking into account the Chartered Institute of Internal Auditors' Guidance on Effective Internal Audit in the Financial Services Sector;
- Monitoring the execution and continuing appropriateness of the 2021 Internal Audit plan as it reflects strategic developments, emerging risks and corresponding impacts on core business processes and key controls;
- Approving the Internal Audit budget and confirming it is satisfied that Internal Audit has the appropriate resources, including use of subject matter experts where appropriate, to deliver the audit plan;
- Receiving regular reports from the Chief Audit Officer on Internal Audit activities undertaken in 2021 and monitoring improvement activities resulting from Internal Audit reports;
- Reviewing the Internal Audit annual effectiveness self-assessment against industry standards;
- Reviewing the interaction and alignment between Internal Audit and the Risk function and between Internal Audit and the external auditor; and
- Confirming that Internal Audit maintains its independence and remains fully informed of management's and the Risk function's reporting and views on risks and the internal control environment.

# Audit Committee report (continued)

**Effectiveness of the relationship with the external auditor**

The Committee is responsible for the effectiveness of TSB's relationship with its external auditor and for assessing their independence and objectivity. During 2021 the Committee discharged this responsibility by:

- Agreeing the terms of the audit engagement letter and reviewing and approving the audit fee proposal. Fees paid to the external auditor are set out in note 14 to the consolidated financial statements on page 84;
- Reviewing and challenging, throughout the year, the external auditor's audit strategy and consideration of significant risks and other areas of audit focus to ensure TSB's circumstances are appropriately reflected. The Committee also challenged KPMG to consider adopting an audit approach with an increased reliance on business and automated controls as they mature;
- Receiving reports from the external auditor covering management's estimates and judgements;
- Reviewing the outcomes of the Financial Reporting Council's Audit Quality Review inspection reports as they relate to KPMG and the steps taken by KPMG to address the findings from the inspection reports where they are relevant to the TSB audit;
- Considering the approach to obtaining independent assurance over outsourced controls;
- Ongoing review of the audit service through regular discussions between the Chair of the Audit Committee, Chief Financial Officer, and Chief Risk Officer, and KPMG's audit engagement personnel. In addition, a review of the effectiveness and quality of the external audit service is undertaken and referred to the Committee each year;
- Ensuring compliance with policy governing the use of the external auditor for non-audit services to safeguard their objectivity and independence (see note 14 on page 84 for fees paid to the external auditor); and
- Reviewing and challenging reports from the external auditor on maintaining their independence including evidencing consideration of compliance with UK regulations and ethical standards, KPMG firm wide processes and controls, and the potential for threats to independence at a firm and personal level arising from a range of sources, for example, dependence on non-audit services, other business or personal relationships, familiarity or undue influence by TSB management.

The audit of the 2021 financial statements is the second to have been undertaken by KPMG following a competitive tender undertaken in 2018 for the audit of the 2020 financial statements. Pamela McIntyre was the senior statutory auditor for the audit of the 2021 financial statements, her second audit of TSB's financial statements.

A resolution to re-appoint KPMG for the audit of the financial statements for the year ending 31 December 2022 will be proposed at the 2022 Annual General Meeting.

# Directors' report

**Introduction**
The Directors of TSB Banking Group plc (the Company) present their report and audited consolidated financial statements for the year ended 31 December 2021, in accordance with section 415 of the Companies Act 2006.

The following information is incorporated into this Directors' report:
- The 'Disability inclusion' (page 24), 'Involvement of employees in business / consulting with employees' (page 25) and 'Summary of Streamlined Energy and Carbon Reporting' (page 27) sections of 'Being a responsible business';
- The 'Businesses' and 'Employees' sections of Section 172 statement (pages 30 to 31);
- The 'How the business is managed' section of the Corporate governance statement (pages 33 to 40); and
- The 'Diversity and inclusion' section of the Nomination Committee report (page 42).

**Results and dividends**
The consolidated balance sheet can be found on page 63 and the consolidated statement of comprehensive income is on page 64. The Directors do not currently propose to pay a dividend.

**Directors**
The Directors of the Company who were in office at any time during the year and up to the date of signing the financial statements were:

| | |
|---|---|
| Nick Prettejohn | (appointed 1 November 2021) |
| Richard Meddings | (resigned 29 November 2021) |
| Robin Bulloch | (appointed 16 December 2021) |
| Debbie Crosbie | (resigned 2 December 2021) |
| Declan Hourican | (appointed 13 September 2021) |
| Ralph Coates | (resigned 13 September 2021) |
| Adam Banks | (appointed 8 February 2021) |
| Paulina Beato | (resigned 21 March 2021) |
| Elizabeth Chambers | |
| César González-Bueno | (resigned 18 May 2021) |
| Lynne Peacock | |
| Mark Rennison | |
| Alicia Reyes | (appointed 18 May 2021) |
| Andy Simmonds | |
| Tomás Varela | |
| David Vegara | |
| Polly Williams | (resigned 5 March 2021) |

The biographies of TSB's Directors are available at www.tsb.co.uk/investors/people/. The Company's articles of association (the Articles) give the Directors power to appoint and replace Directors. Directors can also be appointed or removed from office by written notice provided to the Company by Sabadell as the sole shareholder.

**Power of Directors**
The Directors are responsible for managing the business of the Company and may exercise all the powers of the Company so long as the Articles or applicable legislation do not stipulate that any such powers must be exercised by the shareholder.

**Directors' indemnities**
Each of the Directors has the benefit of a deed of indemnity which constitutes a 'qualifying third party indemnity provision'. This indemnification for Directors provided by the Company has been arranged in accordance with the Articles and the Companies Act 2006.

With the exception of the Directors appointed during 2021, the indemnities were in place throughout 2021. The indemnity for Adam Banks was executed on 8 February 2021, for Alicia Reyes on 18 May 2021, for Declan Hourican on 14 September 2021, and for Nick Prettejohn on 1 November 2021. The indemnity for Robin Bulloch was executed on 14 January 2022. Each of the indemnities remain in force at the date of signing these financial statements and are available for inspection at the Company's registered office.

# Directors' report (continued)

**Directors' emoluments waiver**

David Vegara does not receive a fee as a Non-executive Director of the Company. Tomás Varela did not receive a fee as a Non-executive Director of the Company between 1 January 2021 and 3 March 2021, during which time he was remunerated by Sabadell. César González-Bueno ceased to receive a fee as a Non-executive Director of the Company on 18 December 2020 following his appointment and remuneration by Sabadell as its Chief Executive Officer. None of the other Directors, save for Richard Meddings and Nick Prettejohn, who as Chairman waived their respective entitlement to the fee for membership of the Nomination Committee, have waived their emoluments during the period under review, nor have they agreed to waive future emoluments.

**Governance arrangements**

The Board has chosen to voluntarily adopt those principles of the UK Corporate Governance Code (Code) that are considered appropriate for TSB as a wholly owned subsidiary of Sabadell. Details of the aspects of the Code not considered appropriate for TSB, together with areas where TSB has deviated from the recommendations of the Code and the rationale for this, are set out on page 33.

**Share capital**

At 26 January 2022, the total issued share capital with voting rights consisted of 500,000,000 ordinary shares of £0.01 each. The total issued share capital is held by Banco de Sabadell, S.A.

**Future developments**

The development of TSB is set out in the Chief Executive's statement on pages 4 to 5.

**Political donations and expenditure**

No amounts were given for political purposes during the year.

**Financial risk management and hedging policies**

Details of the use of financial instruments, together with risk management disclosures can be found in the Managing financial risk section of the financial statements on pages 87 to 104 and the Risk management section in the Strategic report on pages 13 to 20.

**Post balance sheet events**

There are no significant events affecting TSB that have arisen between 31 December 2021 and the date of this report that require disclosure.

**Research and development activities**

TSB develops new products and services during the ordinary course of business.

**Overseas branches**

TSB does not have any branches outside of the United Kingdom.

**Corporate headquarters and registered office**

The corporate headquarters and registered office address for TSB Banking Group plc is 20 Gresham Street, London, EC2V 7JE. Website: www.tsb.co.uk.

**Disclosure of information to external auditor**

In accordance with the provisions of the Companies Act 2006, the Directors serving at the date of approval of this report confirm that, so far as each Director is aware, there is no relevant audit information of which the Company's auditor is unaware and each Director has taken all the steps that he or she ought to have taken as a Director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

**Going concern**

The Directors recognise their responsibility to make an assessment of TSB's ability to continue as a going concern, for a period of at least 12 months from the date the financial statements are approved. The Directors' assessment of going concern is integrated with the assessment of the viability of TSB. The Directors, having taken into account the matters noted in the 'Basis of preparation' on page 61, are satisfied that adequate funding, liquidity and capital resources will be in place to allow the financial statements to continue being prepared on a going concern basis and are not aware of any material uncertainties that may cast significant doubt upon TSB's ability to continue as a going concern.

# Directors' report (continued)

**Viability statement**

As more fully explained in the Corporate governance statement on page 33, TSB has committed to voluntarily adopt provisions of the Code appropriate for a wholly owned subsidiary. This includes the provisions that require the Directors to confirm that TSB will be able to continue in operation and to meet its financial liabilities as they fall due over a specified period determined by the Directors taking account of the current position and principal risks of TSB.

The Directors have assessed viability to December 2024. The assessment has been made over this period as it is within the period over which TSB's medium term strategic and financial plan is prepared, key capital and leverage ratios are forecast and regulatory and internal stress testing of the profit, capital and funding forecasts are carried out. In doing so, it took into account the increasing uncertainty of forecasts in the outer years of the planning period from developments in the economic environment, and competition and regulatory developments.

The Directors confirm that they have carried out a robust assessment of the emerging and principal risks facing TSB, the procedures in place to identify emerging risks, and how such risks are being managed or mitigated, and, in light of TSB's capital and funding resources, they have a reasonable expectation that TSB will be able to continue in operation and meet its liabilities as they fall due in the period to December 2024.

In making this assessment, the Directors have considered a wide range of information. Central to this assessment is the 2021 medium term plan. This includes assessment of future projections of profitability, capital requirements, capability, resources and funding. In addition, the Directors have assessed the key strategic and horizon risks that could threaten TSB's prospects and business model more broadly and the monitoring and mitigation activities around them.

**Statement of directors' responsibilities in respect of the annual report and the financial statements**

The Directors are responsible for preparing the annual report and the consolidated and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare consolidated and Company financial statements for each financial year. Under that law they are required to prepare the consolidated financial statements in accordance with UK adopted international accounting standards 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 consolidated group and of the Company and of the consolidated group's profit or loss for that period. In preparing each of the consolidated group and 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 UK adopted international accounting standards;
- assess the consolidated group and 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 consolidated group or the 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 and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the consolidated group and to prevent and detect fraud and other irregularities.

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

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

# Directors' report (continued)

**Fair, balanced and understandable**

The Board has ultimate responsibility for reviewing and approving the annual report. In voluntarily adopting the principles of the Code that are considered appropriate for TSB as a wholly owned subsidiary of Sabadell, the Directors confirm that they consider that the annual report, taken as a whole, is fair, balanced and understandable and provides the information necessary for the shareholder to assess the Company's position, performance, business model and strategy. When arriving at this conclusion the Board was assisted by a number of processes including:

- The annual report is drafted and comprehensively reviewed by appropriate senior management with overall co-ordination by the Financial Controller;
- A verification process is undertaken to ensure factual accuracy, with additional review of compliance with content and disclosure requirements by TSB's legal team; and
- The annual report is reviewed by TSB employees from a range of functions, TSB's Executive Committee and the Audit Committee prior to approval by the Board. Additionally, the Risk management disclosures, Remuneration review and Nomination Committee report are reviewed by the Risk, Remuneration and Nomination Committees, respectively.

By order of the Board
**Keith Hawkins**
*Company Secretary*
*26 January 2022*
*Registered in England and Wales, Company Number 08871766*

# Remuneration review

Ever since TSB was relaunched onto high streets across Great Britain, the remuneration approach has remained consistent. It is designed to be simple and fair. This underlying principle remains integral to our reward philosophy.

**Overview of TSB's remuneration policy for 2021**

The aim of TSB's remuneration policy is to provide competitive remuneration aligned to the delivery of the Bank's strategic goals and culture. It is designed to attract and retain talented individuals and to generate sustainable business performance, while taking into account effective risk management and appropriate conduct. In addition, TSB aims to align the remuneration approach with that of its parent, Sabadell.

The key elements of the reward framework are as follows:

- Salary – which provides core remuneration taking into account relevant market benchmarks, complexity of the role and the individual's experience and performance.

- Variable pay - which comprises of the Variable Pay Award and the Long Term Incentive Plan (LTIP).

  The Variable Pay Award – For grades B to F, 90% is based on in-year performance measured against the Primary Corporate Objectives (PCOs), being five key priorities that clearly link to TSB's purpose and blueprint behaviours, as well as the strategic plan. 10% of the award is based on Sabadell Group performance. The Variable Pay Award will be granted to all employees if affordability thresholds are met, along with risk management gateways.

  The LTIP - In December 2021, the Remuneration Committee approved the introduction of a new LTIP. This will have the benefit of further aligning TSB to the Sabadell Group remuneration structure and bring TSB more in line with UK market practice. The first awards will be made in Sabadell shares in April 2022 for a three year performance period (2022 to 2024) to a small number of senior management. The LTIP will be subject to Sabadell performance metrics.

  From the start of 2020, TSB no longer uses individual performance ratings and, instead, has developed and enhanced the performance management process. As well as enhancing the transparency of the process, the focus is on improving performance rather than measuring it and encouraging coaching and development through frequent feedback and regular conversations between employees and line managers. Employees who achieve their personal objectives, demonstrate the core behaviours, regularly meet or go beyond the expectations of their role and whose performance is not classified as 'needs improvement', will be eligible for a Variable Pay Award.

  The individual performance rating process for the most senior levels has been replaced with an assessment against the PCOs (70%), individual contribution (individual behaviours and areas of strategic focus) (20%), and group performance metrics (10%). The financial and non-financial metrics in the individual scorecards are taken from the wider set of TSB's PCOs as well as Sabadell Group metrics.

- Market appropriate benefits – which include, principally, pension contributions to a defined contribution scheme or where appropriate, an equivalent cash payment; 4% of salary available to use in our flexible benefits offering; and an employer provided car or alternative cash allowance at certain grades. In 2021, as part of TSB's commitment to be a carbon net zero organisation by 2030, an electric car scheme was introduced. A digital total reward statement was delivered to all colleagues in 2021 setting out the total value of the employment package for each individual.

- In respect of 2021 performance, TSB will not exceed an annual cap on total variable remuneration of one times fixed pay, calculated in accordance with the PRA's remuneration regulations.

**Consideration for all TSB employees**

The Executive Committee has agreed to set a salary increase budget of 4.0%, based on the 2021 performance year, reflecting external economic indicators and market positioning (salary changes effective from 1 April 2022). This will bring the entry level salary to £21,000 for our non London roles (16.5% above the Real Living Wage minimums). Employees will be differentiated based on their position within their salary band. More senior employees in grades G and H, including Executive Committee members, will receive any salary rise by exception only to reflect individual market positioning.

TSB was an early champion of the Real Living Wage becoming an accredited Real Living Wage employer in August 2016. Our commitment to paying a decent wage based on living costs continues.

The Remuneration Committee is provided with regular reports on the broader workforce, ensuring its members are familiar with employee trends and other data when considering executive pay.

# Remuneration review (continued)

**Diversity and inclusion**
In 2020 TSB published the Do What Matters plan, providing a new framework to support TSB's ambition to create a truly inclusive workplace. TSB's commitments in this regard are set out in the Directors' report on page 24.

**Outlining TSB's obligations**
TSB's remuneration policy continues to comply with the PRA and FCA Remuneration Codes and the European Banking Authority Guidelines on remuneration and is aligned with the Sabadell remuneration policy.

In respect of variable pay plans, 60% of grants for most Senior Managers will be deferred over seven years with pro-rata release between the third and seventh year based on release underpins. Any shares issued will be subject to a 12 month retention period after the point of release. For a small number of Senior Managers and for MRTs, 40% of grants will be deferred over four or five years, depending on the regulatory status of the employee, with a retention period on the shares of 12 months after the point of release. TSB's approach to deferral of total variable remuneration for senior employees ensures that awards are delivered as required by regulations.

With regard to the requirements of the UK Corporate Governance Code, as outlined on page 33, the Board has committed to voluntarily adopt those principles of the Code that are considered appropriate for TSB as a wholly owned subsidiary, operating in the UK market. This includes the alignment of pension contribution rates for TSB Executive Directors with those available to the wider TSB workforce (Provision 38). To this end, the Remuneration Committee has considered and agreed to implement an approach to align the contribution rates by the Investment Association's 31 December 2022 deadline.

In addition, the Remuneration Committee has not created a policy for post-employment shareholding requirements (Provision 36). TSB Executive Directors are already subject to long deferral periods (seven years with a further one year holding period) for Sabadell shares awarded as part of TSB variable remuneration. Therefore, the current view is that no specific post-cessation shareholding requirement be introduced for TSB Executive Directors at the present time. The Remuneration Committee continues to keep this under review as part of a regular Committee agenda item to consider market developments.

**Reward outcomes in 2021**
2021 has been a positive year for TSB. Financial performance was ahead of plan primarily due to reduced impairments and strong income growth and cost control. TSB generated a statutory profit before tax for 2021 of £157.5 million compared to a loss before tax of £204.6 million in 2020.

The Remuneration Committee has reviewed the business performance in 2021 and taken into account risk events in conjunction with the Board Risk Committee and the affordability of paying variable pay. After the assessment of performance, the Committee has determined that no ex ante risk adjustment of the pool is made. In addition, the Committee has determined that no adjustment to the pool is made as all affordability thresholds have been met. The final pool approved to distribute is £27.2 million. This means that TSB colleagues in grades B to F who are not deemed to be 'needs improvement' will receive 102% of their on target award. Other grades will receive a figure close to this but may differ, up or down, based on their personal and behavioural objectives.

Unvested prior year SPA awards (Sustainable Performance Awards) that were due to vest in March 2022 will not vest, consistent with SPA awards which were due to vest in March 2021, as performance against the predetermined financial target (cumulative return on equity) was not achieved. SPA Awards were deferral awards last granted in 2017 to the senior population.

In 2018, the Committee took the decision to delay the payment of the vested but as yet unpaid tranches of the Sabadell Integration Awards (SIA) and other awards due to vest in March 2022, subject to the outcome of both internal and external regulatory investigations into the post migration issues and subsequent consideration by the Committee in light of any findings. This decision continues to subsist.

# Remuneration review (continued)

**Consideration of conduct and risk**

TSB takes risk and conduct issues very seriously. Risk profile and behaviours are a key gateway that must be satisfied for any incentive awards to pay out. A risk adjustment is made as a result of several factors:

1. A balance of measures included in individual objectives and the Primary Corporate Objectives acts as a framework for adjusting the bonus pool for both performance and risk inherent in TSB's activities;
2. The use of a framework to quantify the risk adjustment of the variable remuneration pool in 2021; and
3. The appropriate governance to make informed and robust decisions, including the Remuneration Governance Group (which makes recommendations to the Remuneration Committee on matters as required to ensure that the appropriate standards of risk management and corporate governance are applied), Remuneration Committee oversight, and independent access to the Chief Risk Officer and Chief Financial Officer.

Incentive pools and awards may be adjusted, including to zero, in the event of material breaches. All elements of variable remuneration for MRTs are subject to malus and clawback provisions in line with regulatory requirements.

**Highest paid Director – 2021 remuneration disclosure (*)**

The table below sets out the total remuneration paid to Debbie Crosbie, TSB's highest paid Director. This covers her remuneration for qualifying services as a Director in the period from 1 January to 2 December 2021, when she resigned from her role as Chief Executive, and as an Executive Director. She was replaced by Robin Bulloch who became the Interim Chief Executive, subject to regulatory approval, on 3 December 2021.

| | 2021 | 2020 |
|---|---|---|
| Basic salary(1) | **£875,941** | £950,000 |
| Benefits(2) | **£44,900** | £48,110 |
| Pension(3) | **£155,062** | £168,217 |
| Fixed Pay | **£1,075,903** | £1,166,327 |
| Variable Remuneration(4) | **–** | – |
| Joining awards vesting during the year (5) | **–** | – |
| **Total Remuneration (audited)** | **£1,075,903** | £1,166,327 |

**Notes**

(1) Salary from 1 January to 2 December 2021.
(2) Benefits include the taxable value of all benefits received, which included a car allowance and a flexible allowance set at 4% of basic salary.
(3) The value of the pension allowance provided which has been paid at a percentage of 17.7%.
(4) 2020 variable pay was voluntarily waved. Ineligible for 2021 variable pay due to resignation.
(5) There were no cash instalments paid to Debbie Crosbie prior to her resignation in 2021 in relation to awards granted to compensate for the forfeit of unvested variable remuneration when she left employment with her previous firm, Virgin Money UK PLC (formerly CYBG PLC). In respect of the share based element of these joining awards, 43,198 Sabadell shares vested in 2021 and will be released in 2022.

(*) The aggregate remuneration for all Directors is set out in note 15 to the financial statements on page 84.

**Consideration by the Directors of matters relating to Directors' remuneration**

The Remuneration Committee is authorised by the Board to consider and recommend to the Board the remuneration policy. The policy is considered regularly by the Remuneration Committee, taking account of changes in regulation and the wider market. In formulating and reviewing policy, independent advice is sought and considered. In particular, the sustainability of the policy and its risk impact are carefully reviewed. The remuneration policy is formally reviewed at least annually and once endorsed by the Remuneration Committee, is reviewed and approved by the Board. The Remuneration Committee's terms of reference are kept under regular review and can be found at http://www.tsb.co.uk/investors/people/.

The Remuneration Committee is chaired by Lynne Peacock and the other committee members in 2021 were Elizabeth Chambers, Adam Banks (from 23 March 2021), and Alicia Reyes (from 27 July 2021). The following members also served on the Remuneration Committee for part of the year, until the respective dates that they stepped down from the Board: Polly Williams (until 5 March 2021), Paulina Beato (until 21 March 2021) and César González-Bueno (until 18 May 2021).

To ensure alignment between the work of the Remuneration Committee and the Risk Committee, Andy Simmonds, Chair of the Risk Committee, has a standing invitation to join the Remuneration Committee meetings. Remuneration Committee meetings are also attended by the Chairman together with the Chief Executive, HR Director and Director of Reward and Performance, independent remuneration committee advisors and from time to time the Chief Financial Officer and the Chief Risk Officer attend to provide input on their specialist areas.

# Remuneration review (continued)

**Consideration by the Directors of matters relating to Directors' remuneration (continued)**
The Company Secretary, or an appropriate delegate, acts as the secretary to the Remuneration Committee. None of these additional attendees participates in the discussion of issues directly affecting their own remuneration. Following a widespread review of potential Remuneration advisors, the Remuneration Committee appointed PwC to provide independent advice on remuneration matters from 1 April 2021. For the period to 31 March 2021, advice was provided by Deloitte LLP.

PwC is a member of the Remuneration Consultants Group and, as such, voluntarily operates under the code of conduct in relation to executive remuneration consulting in the UK. PwC has provided independent advice on matters under consideration by the Remuneration Committee including compliance with regulations, advice on market trends and data, remuneration policy and implementation of remuneration arrangements, including support in remuneration arrangements for departing Executives. The Remuneration Committee is satisfied that the advice it has received has been objective and independent.

PwC also provided advice on share plans, wider remuneration matters, taxation and financial matters and other miscellaneous consulting and assurance services. In addition, management received external advice, including market data and legal counsel, from a number of other providers which is not considered to be material in assisting the Remuneration Committee to consider Directors' remuneration.

# Leadership team biographies

**Chairman and Executive Directors:**

***Nick Prettejohn – Chairman***
Nick was appointed to the Board on 1 November 2021 and, following regulatory approval, succeeded Richard Meddings as TSB's Chairman on 29 November 2021.

Nick has more than 30 years of executive experience, in-depth financial services and regulatory knowledge, and a strong track record of leading boards and businesses. Nick worked in various positions across consulting, strategy and business development before becoming Chief Executive of Lloyd's of London, managing the institution through the 9/11 crisis. He has also served as CEO of Prudential UK and Europe.

From 2014 until September 2021, Nick was a Non-executive Director of Lloyds Banking Group ('LBG'), and Chairman of LBG's subsidiary, Scottish Widows Group. He has also chaired the Financial Services Practitioner Panel and the FCA's Financial Advice Working Group; the Britten-Pears Foundation; Brit Insurance and the Royal Northern College of Music; and was Non-executive Director of the PRA and Legal and General plc; Member of the BBC Trust; and Trustee of the Royal Opera House.

He is currently Chairman at media group Reach plc and human rights charity Prisoners Abroad and is also a Non-executive Director at Opera Ventures.

***Robin Bulloch – Interim Chief Executive***
Robin was appointed TSB's Interim Chief Executive in December 2021, subject to regulatory approval.

He joined TSB in 2019, and as Chief Customer Officer was at the heart of transforming the TSB customer experience. He has driven the bank's customer proposition and distribution strategies as well as developing the bank's support for business customers. In 2020, he led the TSB brand relaunch.

Robin has broad industry expertise across consumer banking, business banking and insurance with a strong reputation for delivering business and cultural transformation in a banking career that spans over four decades.

Before joining TSB, Robin was Managing Director for Community Banking at Lloyds Bank and Bank of Scotland prior to which he led Lloyds Banking Group's general insurance division. Prior to this he worked for RBS Group (now NatWest Group), holding senior roles including Managing Director at RBS and NatWest Branch Banking and Chief Executive of Tesco Personal Finance (now Tesco Bank).

Robin sits on the CBI Scotland Council. He is also a Fellow of the Chartered Banker Institute, having previously served on their Board and the Board of Scottish Financial Enterprise.

***Declan Hourican – Chief Financial Officer***
Declan joined TSB as a member of the Executive Committee and the Board on 13 September 2021.

Declan is responsible for TSB's financial stewardship and economic contribution, including the funding, investment, planning and reporting that are core to TSB's growth strategy.

From 2016, Declan was the Chief Financial Officer at Tesco Bank, where he played a central role in delivering against the bank's goal of supporting customers. He also led the acquisition of its joint venture, Tesco Underwriting, as part of a broader transformation of the insurance business.

Declan spent fourteen years at Royal Bank of Scotland (RBS) where he held various CFO roles, including in restructuring, non-core, retail banking and insurance.

He is a fellow of the Institute of Chartered Accountants and a graduate of University College Dublin and the Michael Smurfit Graduate School of Business, also in Dublin.

The biographies of TSB's Non-executive Directors can be found at www.tsb.co.uk/investors/people/.

# Leadership team biographies (continued)

**TSB Executive Committee members:**
In addition to Robin Bulloch (Interim Chief Executive) and Declan Hourican (Chief Financial Officer), the following individuals comprise the membership of the Executive Committee.

***Liz Ashford – HR Director***
Liz was appointed as TSB HR Director in 2019.

Leading all people aspects of TSB's growth strategy, Liz has driven employee engagement, with a strong focus on creating an inclusive workplace. She works closely with the TSB Board's Remuneration Committee and is Executive sponsor of both TSB's programme to improve diversity and inclusion and TSB's Ability network.

Liz brings significant experience leading change and business transformation gained from a career that has spanned financial services, as well as retail and utilities sectors. This includes investment banking at both HSBC and ABN AMRO, the private bank Kleinwort Benson, the energy company Essent (part of RWE), Harrods and Aviva where she was the Global People Director, Aviva Investors.

***Mark Curran – Interim Customer Banking Director***
Mark was appointed Interim Customer Banking Director and joined the Executive Committee in December 2021.

In this role he is responsible for providing a product proposition that meets our customers' needs, making them feel money confident whilst driving commercial growth. The Customer Banking function is at the heart of ensuring customers are treated fairly and Mark champions good conduct across the business.

Mark joined TSB in 2019 as the Director of Technology Transformation, leading the project to insource TSB's key technology services. He then moved to Customer Banking as the Business Banking Director and has been responsible for transforming TSB's business banking offering and improving the customer experience.

Mark has worked in retail banking for over 30 years and has held positions in payments, IT, retail and digital at Clydesdale and Yorkshire Bank Group / Virgin Money UK, RBS/NatWest and Lloyds Banking Group. He has also chaired industry-wide programmes to deliver the UK's Current Account Switching Service and the move to digital cheque imaging. He is a Chartered Banker and Fellow of the Chartered Banker Institute.

***Guy Dunlop – General Counsel***
Guy was appointed TSB General Counsel in 2019.

He leads the Legal and Company Secretariat teams that provide a broad range of legal and regulatory advice, legal risk management, strategic counsel, company secretarial services and governance advice and support to all areas of the Bank.

He is Executive sponsor of the LGBTQ+ network which was awarded a top 10 place in the Global Diversity List 2020. Prior to joining TSB, Guy was the General Counsel for The Prudential (UK and European business unit). Before this he held senior roles with Freshfields Bruckhaus Deringer, Clifford Chance and Genworth Financial Mortgage Insurance. Guy is qualified as a solicitor in England and Wales and in his native South Africa.

***George Gordon – Communications and Corporate Affairs Director***
George was appointed TSB Communications and Corporate Affairs Director in 2018.

He leads media relations, employee communications, government affairs and corporate responsibility programmes, with a remit focused on enhancing TSB's reputation. He is Executive sponsor of TSB's Community programmes.

George brings over 20 years of leadership experience from roles in retail, consumer goods, government and financial services. Prior to TSB, George worked for Tesco for eight years, where he played a key part in the recovery of the business, serving as UK & Ireland Communications Director and as Head of Communications at Tesco Bank. Prior to that he worked for Unilever for 14 years, including a two-year secondment to the UK Government (Cabinet Office) advising ministers and policymakers on better regulation.

# Leadership team biographies (continued)

**TSB Executive Committee members (continued):**

***Gary Jones – Customer Delivery Director***
Gary was appointed Customer Delivery Director and joined the Executive Committee in June 2021.

Gary leads the Customer Journey Transformation programme, TSB's branch network and branch transformation programme, contact centre, property, and self-serve and cash services.

He has over 30 years of experience in financial services with a breadth of expertise in managing large scale customer transformation programmes. Gary joined TSB in 2020 and has been pivotal in improving the customer experience and evolving the way TSB runs its branches and contact centres to improve their overall customer focus and efficiency.

Before joining TSB, he was Customer Service Director at Clydesdale and Yorkshire Bank Group (now Virgin Money UK) for four years, transforming the operations of the bank whilst playing a key part in the successful acquisition and integration of Virgin Money. Prior to this, he was at Lloyds Banking Group for eight years and HBOS for nineteen years, where he held a number of executive roles across strategy, operations, service delivery and business banking.

Gary is a member of the Chartered Banker Institute.

***Carlos Paz – Chief Risk Officer (CRO)***
Carlos was appointed TSB Chief Risk Officer in January 2020.

Carlos oversees TSB's risk management approach, working closely with the Board Risk Committee, and manages the bank's relationships with regulators. He is the Executive sponsor of TSB's programme for helping small businesses thrive.

Carlos originally joined TSB as Chief Audit Officer in 2016 from Sabadell where, as Chief Risk Control Officer, he led the design, development and oversight of the Group's risk appetite framework. Prior to this he was the Chief Financial Officer of Catalunya Bank for three years, where, during the global financial crisis, he was appointed to work closely with the Spanish regulator and the European Commission to develop and implement the resolution plan for the bank.

***Vanessa Swanton – Chief Audit Officer***
Vanessa was appointed TSB Chief Audit Officer in June 2020.

Vanessa leads the internal scrutiny of the work to deliver TSB's growth strategy, working closely with the Board Audit Committee. She is also the Executive sponsor of TSB's Gender Balance network.

Vanessa joined TSB from insurance company LV (Liverpool Victoria) where she was Chief Internal Auditor for two years. Prior to that, Vanessa was a Director at the management consultants, Ernst & Young. She began her career at Lloyds Banking Group where she spent 16 years working across all areas of the group and three lines of defence.

***Suresh Viswanathan – Chief Operating Officer***
Suresh was appointed as TSB Chief Operating Officer in 2019.

Suresh has overseen the digital transformation at TSB, a cornerstone of the growth strategy, and leads our corporate services, operations and technology functions. He is also Executive sponsor of both the Ethnicity at TSB network and TSB's programmes to reduce environmental impact.

He has over 30 years of experience in technology and financial services, specialising in setting up complex global technology operations and integrations. Suresh began his career at Citi Group, where he set up their branch-banking platform and led acquisition and integrations across Central and Eastern Europe, Middle East and Africa. He joined Barclays in 2008 as Chief Information Officer for Barclays Corporate Bank and then went on to lead Operations and Technology for Barclays UK, where he helped set up their ring-fenced bank. In 2020, he became an advisory board member of Rackspace Technology.

# Financial statements

## Alignment with TSB's business model

**The presentation of TSB's consolidated financial statements aligns with the execution of its strategy, its business model and the management of the financial risk to which it is exposed. As such, the consolidated financial statements are structured around the key elements of TSB's business model as explained on page 6.**

### Basis of preparation

These consolidated financial statements of TSB Banking Group plc (TSB) comprise the results of TSB Banking Group plc (the Company) consolidated with those of its subsidiaries, including TSB Bank plc. Details of subsidiary undertakings are provided in note 4 to the Company financial statements on page 116. These consolidated financial statements have been prepared in accordance with UK adopted international accounting standards.

The consolidated financial statements have been prepared under the historical cost convention as modified by the recognition of certain financial instruments, including derivative contracts, at fair value through profit or loss, and financial assets at fair value through other comprehensive income.

#### *Going concern*

The going concern basis is dependent on maintaining enough capital and funding of the balance sheet. The directors considered a number of factors including forecasts for TSB and its capital and liquidity position. TSB's business activities and objectives, together with the factors likely to affect its future development, performance and position are set out in the Strategic report. In 2021, TSB reported a profit before tax for the year of £157.5 million (2020: £204.6 million loss before tax) and continues to be in compliance with, and exceeds, its regulatory capital and liquidity requirements.

As part of those forecasts, the Directors have modelled the impact of a severe but plausible downside stress in line with the severe downside (low interest rate) scenario described in note 8 on page 75. Based on the forecasts and the stress performed, the Directors are satisfied that TSB will have sufficient regulatory capital and liquidity for a period of at least 12 months from the date of approval of these financial statements. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

#### *Accounting policies*

The significant accounting policies used in the preparation of the consolidated financial statements are consistent with those applied in 2020. The accounting policies are presented in a manner consistent with TSB's business model and are included in the relevant sections of the consolidated financial statements. In addition, the following accounting policies relate to the consolidated financial statements as a whole.

*Consolidation* - Subsidiaries are all entities (including special purpose entities) over which TSB has control. TSB controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to TSB and are deconsolidated from the date that control ceases. Inter-company transactions, balances and unrealised gains and losses on transactions between group entities are eliminated.

*Foreign currency translation* - Foreign currency transactions are translated using the exchange rates prevailing at the date of the transaction. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in other operating income in the income statement.

#### *Significant accounting estimates and judgements*

The preparation of financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions in applying the accounting policies that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgements and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The significant judgements made by management in applying accounting policies and the key sources of estimation uncertainty in these consolidated financial statements, which together are deemed critical to the results and financial position, are presented within the relevant note disclosures. These areas are discussed in the Audit Committee report as set out in the corporate governance statement on pages 45 to 46.

# Index to the consolidated financial statements

TSB's primary consolidated financial statements are presented on pages 63 to 65. The notes to these consolidated financial statements are structured to follow TSB's business model as set out on page 6 and are listed below.

# Consolidated balance sheet

## as at 31 December 2021

| | Note | 2021 £ million | 2020 £ million | Reference to business model |
|---|---|---|---|---|
| **Assets** | | | | |
| *Financial assets at amortised cost* | | | | |
| Cash, cash balances at central banks and other demand deposits | 31 | **4,851.2** | 5,056.6 | *Loans and liquid assets (page 70)* |
| Debt securities | 6 | **2,166.7** | 1,123.7 | |
| Loans and advances to customers | 8 | **37,383.8** | 33,317.9 | |
| Loans and advances to central banks and credit institutions | 7 | **199.7** | 164.2 | |
| Other advances | 9 | **80.7** | 220.2 | |
| *Financial assets at fair value through other comprehensive income* | | | | |
| Debt securities | 6 | **1,069.0** | 1,496.9 | |
| *Financial assets at fair value through profit or loss* | | | | |
| Derivative financial assets not in hedge accounting relationships | 21 | **169.3** | 198.3 | *Managing risk (page 87)* |
| Hedging derivative financial assets | 21 | **244.5** | 139.9 | |
| Fair value adjustments for portfolio hedged risk | 21 | **(109.3)** | 80.2 | |
| Property and equipment | 25 | **300.3** | 258.9 | Other important disclosures (page 105) |
| Intangible assets | 27 | **72.1** | 49.5 | |
| Deferred tax assets | 17 | **123.3** | 145.2 | Charges (page 82) |
| Other assets | 28 | **137.5** | 155.2 | |
| **Total assets** | | **46,688.8** | 42,406.7 | |
| | | | | |
| **Liabilities** | | | | |
| *Financial liabilities at amortised cost:* | | | | |
| Customer deposits | 1 | **35,951.9** | 34,375.3 | *Sources of funding (page 66)* |
| Borrowings from central banks | 2 | **5,501.6** | 3,065.8 | |
| Debt securities in issue | 2 | **2,199.1** | 1,699.2 | |
| Subordinated liabilities | 3 | **291.8** | 391.3 | |
| Lease liabilities | 26 | **163.5** | 123.3 | |
| Other financial liabilities | 4 | **194.3** | 51.6 | |
| *Financial liabilities at fair value through profit or loss* | | | | |
| Derivative financial liabilities not in hedge accounting relationships | 21 | **156.5** | 302.3 | *Managing risk (page 87)* |
| Hedging derivative financial liabilities | 21 | **136.8** | 225.2 | |
| Fair value adjustments for portfolio hedged risk | 21 | **(63.6)** | 117.0 | |
| Provisions | 29 | **110.2** | 153.1 | Other important disclosures (page 105) |
| Other liabilities | 30 | **196.8** | 196.0 | |
| **Total liabilities** | | **44,838.9** | 40,700.1 | |
| | | | | |
| **Equity** | | | | |
| Share capital | 22 | **5.0** | 5.0 | |
| Share premium | 22 | **965.1** | 965.1 | |
| Other reserves | 22 | **(285.1)** | (285.1) | |
| Retained profits brought forward | 22 | **1,030.2** | 1,189.9 | |
| Profit/(loss) attributable to the shareholder for the current year | 22 | **130.2** | (159.7) | |
| Fair value reserve | 22 | **11.1** | 11.6 | |
| Cash flow hedging reserve | 22 | **(6.6)** | (20.2) | |
| **Shareholder's equity** | | **1,849.9** | 1,706.6 | |
| **Total equity and liabilities** | | **46,688.8** | 42,406.7 | |

The accompanying notes are an integral part of the consolidated financial statements. The consolidated financial statements on pages 63 to 112 were approved by the Board of Directors on 26 January 2022 and signed on its behalf by:

**Robin Bulloch**
*Interim Chief Executive*

**Declan Hourican**
*Chief Financial Officer*

# Consolidated statement of comprehensive income

## for the year ended 31 December 2021

| Income statement: | Note | 2021 £ million | 2020 £ million |
|---|---|---|---|
| Interest and similar income: | | | |
| Interest income calculated using the effective interest method | 11 | **946.4** | 922.0 |
| Other interest income | 11 | **(35.0)** | (41.0) |
| Total interest and similar income | | **911.4** | 881.0 |
| Interest and similar expense | 11 | **(42.5)** | (94.6) |
| **Net interest income** | 11 | **868.9** | 786.4 |
| Fee and commission income [(1)] | 12 | **121.8** | 104.6 |
| Fee and commission expense [(1)] | 12 | **(18.2)** | (18.7) |
| Net fee and commission income | 12 | **103.6** | 85.9 |
| Net gains/(losses) on financial assets and liabilities: | | | |
| Gains on derecognition of financial assets measured at fair value through other comprehensive income | | **7.0** | 21.8 |
| Losses on equity instruments at fair value through profit or loss | | **–** | (0.4) |
| Losses on derivative financial assets at fair value through profit or loss | | **(0.4)** | (5.0) |
| (Losses)/gains from hedge accounting | 21 | **(2.4)** | 5.8 |
| Losses on derecognition of non-financial assets | | **(2.6)** | (3.5) |
| Other operating income | 13 | **10.9** | 37.8 |
| **Other income** | | **116.1** | 142.4 |
| **Total income** | | **985.0** | 928.8 |
| **Total operating expenses** | 14 | **(827.4)** | (969.4) |
| **Operating profit/(loss) before impairment losses and taxation** | | **157.6** | (40.6) |
| Impairment losses on financial assets at amortised cost | 18 | **(2.6)** | (162.7) |
| Impairment credit/(losses) on loan commitments | 29 | **2.5** | (1.3) |
| **Total impairment losses** | | **(0.1)** | (164.0) |
| **Profit/(loss) before taxation** | | **157.5** | (204.6) |
| Taxation | 16 | **(27.3)** | 44.9 |
| **Profit/(loss) for the year** | 22 | **130.2** | (159.7) |
| | | | |
| **Other comprehensive income/(loss):** | | | |
| Items that may be subsequently reclassified to profit or loss: | | | |
| *Change in fair value reserve:* | | | |
| Change in fair value | 21 | **6.2** | 14.8 |
| Transfers to the income statement | 21 | **(7.0)** | (17.0) |
| Taxation thereon | 17 | **0.3** | 0.2 |
| | 22 | **(0.5)** | (2.0) |
| *Change in cash flow hedging reserve:* | | | |
| Change in the fair value of derivatives in cash flow hedges | 21 | **24.0** | (21.5) |
| Transfers to the income statement | 21 | **(5.4)** | (2.9) |
| Taxation thereon | 17 | **(5.0)** | 6.7 |
| | 22 | **13.6** | (17.7) |
| **Other comprehensive income/(loss) for the year, net of taxation** | | **13.1** | (19.7) |
| **Total comprehensive income/(loss) for the year** | | **143.3** | (179.4) |

(1) Comparative information for 2020 has been reclassified to align with the current year presentation which has resulted in a reduction in both fee and commission income and fee and commission expense of £17.8 million. There was no change to net fee and commission income previously presented.

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated statement of changes in equity

## for the year ended 31 December 2021

| | Share capital £ million | Share premium £ million | Other reserves: Merger reserve £ million | Other reserves: Capital reorg-anisation reserve £ million | Other reserves: Capital reserve £ million | Fair value reserve £ million | Cash flow hedging reserve £ million | Retained profit £ million | Share-holder's equity £ million |
|---|---|---|---|---|---|---|---|---|---|
| Balance at 1 January 2020 | 5.0 | 965.1 | 616.5 | (1,311.6) | 410.0 | 13.6 | (2.5) | 1,189.9 | 1,886.0 |
| Comprehensive loss: | | | | | | | | | |
| Loss for the year | – | – | – | – | – | – | – | (159.7) | (159.7) |
| Other comprehensive loss | – | – | – | – | – | (2.0) | (17.7) | – | (19.7) |
| Total comprehensive loss | – | – | – | – | – | (2.0) | (17.7) | (159.7) | (179.4) |
| Balance at 31 December 2020 | 5.0 | 965.1 | 616.5 | (1,311.6) | 410.0 | 11.6 | (20.2) | 1,030.2 | 1,706.6 |
| **Comprehensive profit:** | | | | | | | | | |
| **Profit for the year** | – | – | – | – | – | – | – | **130.2** | **130.2** |
| **Other comprehensive income** | – | – | – | – | – | **(0.5)** | **13.6** | – | **13.1** |
| **Total comprehensive income** | – | – | – | – | – | **(0.5)** | **13.6** | **130.2** | **143.3** |
| **Balance at 31 December 2021** | **5.0** | **965.1** | **616.5** | **(1,311.6)** | **410.0** | **11.1** | **(6.6)** | **1,160.4** | **1,849.9** |

The accompanying notes are an integral part of the consolidated financial statements.

# Consolidated cash flow statement

## for the year ended 31 December 2021

| | Note | 2021 £ million | 2020 £ million |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit/(loss) before taxation | | **157.5** | (204.6) |
| Adjustments for: | | | |
| Change in operating assets and liabilities | 31 | **(2,404.6)** | 2,253.9 |
| Non-cash and other items | 31 | **109.9** | 283.2 |
| Taxation paid | | **(8.7)** | – |
| **Net cash (used in)/provided by operating activities** | | **(2,145.9)** | 2,332.5 |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of property and equipment | | **(44.5)** | (30.2) |
| Purchase and development of intangible assets | | **(30.3)** | (35.9) |
| Purchase of debt securities | | **(1,324.5)** | (1,341.3) |
| Sale of debt securities | | **500.9** | 977.8 |
| Proceeds from maturing investments | | **23.0** | – |
| Interest received on debt securities | | **36.3** | 38.8 |
| **Net cash used in in investing activities** | | **(839.1)** | (390.8) |
| | | | |
| **Cash flows from financing activities** | | | |
| Additional borrowings from central banks | | **5,500.0** | – |
| Repayment of borrowing from central banks | | **(3,065.0)** | (1,410.0) |
| Interest paid on borrowings from central banks | | **(7.8)** | (17.2) |
| Issue of debt securities in issue | | **500.0** | 450.0 |
| Interest paid on debt securities in issue | | **(21.0)** | (14.4) |
| Issue of subordinated liabilities | | **300.0** | – |
| Repayment of subordinated liabilities | | **(385.0)** | (440.2) |
| Interest paid on subordinated liabilities | | **(18.8)** | (22.1) |
| Lease payments | | **(22.8)** | (26.4) |
| **Net cash provided by/(used in) financing activities** | | **2,779.6** | (1,480.3) |
| | | | |
| Change in cash and cash equivalents | | **(205.4)** | 461.4 |
| Cash and cash equivalents at 1 January | 31 | **5,056.6** | 4,595.2 |
| Cash and cash equivalents at 31 December | 31 | **4,851.2** | 5,056.6 |

The accompanying notes are an integral part of the consolidated financial statements.

# Notes to the consolidated financial statements

## Sources of funding

**Money deposited by customers into their bank and savings accounts provides the majority of the funds we use to support lending to customers. We also raise funds from other sources, including wholesale markets and central banks, that diversify our funding profile. Our shareholder provides funding in the form of debt and equity capital.**

### Accounting policies relevant to sources of funding

**(a) Financial liabilities**

Financial liabilities include customer deposits, deposits from credit institutions, borrowings from central banks, debt securities in issue, subordinated liabilities, other financial liabilities and derivative financial liabilities (see accounting policy (j) under Managing financial risk).

Financial liabilities which are not derivatives are measured at amortised cost. Issues of financial liabilities measured at amortised cost are recognised on the date that TSB becomes a party to the contractual provisions of the instrument. A financial liability is derecognised from the balance sheet when TSB has discharged its obligations, the contract is cancelled or the contract expires, or where the terms of the debt instrument have been significantly modified.

Borrowings (which include deposits from credit institutions, customer deposits, debt securities in issue and subordinated liabilities) are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. These instruments are subsequently stated at amortised cost using the effective interest rate (EIR) method.

### 1. Customer deposits

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Bank accounts | **14,371.1** | 13,235.6 |
| Instant access saving deposits | **17,042.1** | 16,209.8 |
| Deposits with agreed maturity | **1,757.9** | 2,454.5 |
| Business banking deposits | **2,780.8** | 2,475.4 |
| **Total customer deposits** | **35,951.9** | 34,375.3 |

### 2. Wholesale funding

**(i) Debt securities in issue**

The following table shows debt securities in issue:

| 2021 | Balance at 1 Jan 2021 £ million | Issues/ (Repayments) £ million | Exchange and other adjustments £ million | Balance at 31 Dec 2021 £ million |
|---|---|---|---|---|
| Covered bond programme: | | | | |
| Series 2017-1 covered bonds | **499.0** | **–** | **–** | **499.0** |
| Series 2019-1 covered bonds | **750.1** | **–** | **–** | **750.1** |
| Series 2021-1 covered bonds | **–** | **500.0** | **–** | **500.0** |
| | **1,249.1** | **500.0** | **–** | **1,749.1** |
| Senior unsecured debt securities | **450.1** | **–** | **(0.1)** | **450.0** |
| **Total debt securities in issue** | **1,699.2** | **500.0** | **(0.1)** | **2,199.1** |

| 2020 | Balance at 1 Jan 2020 £ million | (Repayments)/ Issues £ million | Exchange and other adjustments £ million | Balance at 31 Dec 2020 £ million |
|---|---|---|---|---|
| Securitisation programmes: | | | | |
| Duncan Funding 2015-1 plc | 355.7 | (369.0) | 13.3 | – |
| Duncan Funding 2016-1 plc | 70.8 | (71.2) | 0.4 | – |
| | 426.5 | (440.2) | 13.7 | – |
| Covered bond programme: | | | | |
| Series 2017-1 Covered Bonds | 498.9 | – | 0.1 | 499.0 |
| Series 2019-1 Covered Bonds | 750.9 | – | (0.8) | 750.1 |
| | 1,249.8 | – | (0.7) | 1,249.1 |
| Senior unsecured debt securities | – | 450.0 | 0.1 | 450.1 |
| **Total debt securities in issue** | 1,676.3 | 9.8 | 13.1 | 1,699.2 |

## Sources of funding (continued)

### 2. Wholesale funding (continued)

| | Date of issue | 31 Dec 2021 £ million | 31 Dec 2020 £ million | Interest rate at 31 Dec 2021 | Maturity date | Issue currency |
|---|---|---|---|---|---|---|
| **Issuing entity** | | | | | | |
| TSB Bank plc – Series 2017-1 covered bonds | 12/2017 | **499.0** | 499.0 | 0.47% | 12/2022 | GBP |
| TSB Bank plc – Series 2019-1 covered bonds | 02/2019 | **750.1** | 750.1 | 0.94% | 02/2024 | GBP |
| TSB Bank plc – Series 2021-1 covered bonds | 06/2021 | **500.0** | – | 0.55% | 06/2028 | GBP |
| TSB Bank plc – senior unsecured debt securities | 12/2020 | **450.0** | 450.1 | 2.29% | 06/2023 | GBP |
| **Total debt securities in issue** | | **2,199.1** | 1,699.2 | | | |

*Covered bond programmes*

Loans and advances to customers of £2,563.5 million (2020: £1,815.0 million) have been assigned to a limited liability partnership to provide security for the issuance of covered bonds of £1,749.1 million (2020: £1,249.1 million). TSB retains the risks and rewards associated with these loans and the loans continue to be recognised on TSB's balance sheet. The related covered bonds in issue are included within debt securities in issue.

Cash deposits of £56.1 million (2020: £43.3 million) held by TSB are restricted in use to repayment of the term advances related to covered bonds and other legal obligations (note 7 on page 73). At 31 December 2021, TSB had over-collateralised the covered bond programmes in order to meet the programme terms, secure the external credit rating of the covered bonds, and to provide operational flexibility. The obligations of TSB to provide collateral may increase due to the formal requirements of the programmes. TSB may also voluntarily contribute collateral to support the ratings of the covered bonds but did not do so during 2021 or 2020. During 2021 and 2020, there were no defaults on any principal or interest or any other breaches with respect to borrowings under the covered bond programmes.

*Senior unsecured debt securities in issue*

In December 2020, TSB Banking Group plc issued £450.0 million floating rate notes, due to mature in June 2023, to its parent company, Sabadell, to satisfy MREL requirements. These were issued at a price of 100% of the principal amount. The notes pay interest at SONIA plus 2.1% payable quarterly in arrears. The Company has the option to redeem these notes in June 2022 and quarterly thereafter, subject to approval of the PRA.

**(ii) Borrowings from central banks**

At 31 December 2021, borrowing from central banks represented borrowings under the Bank of England's (BoE) Term Funding Scheme with additional incentives for SMEs (TFSME). At 31 December 2020, such amounts were borrowings under the BoE's predecessor Term Funding Scheme (TFS) which were repaid in full during 2021. Borrowings are secured on certain pre-positioned mortgages at the BoE. The borrowings outstanding at 31 December 2021 are due to mature at various dates during 2025.

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Amounts drawn under the TFSME | **5,500.0** | – |
| Amounts drawn under the TFS | **–** | 3,065.0 |
| Accrued interest | **1.6** | 0.8 |
| **Total borrowings from central banks** | **5,501.6** | 3,065.8 |

# Notes to the consolidated financial statements

## Sources of funding (continued)

### 3. Subordinated liabilities

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Fixed-to-floating rate callable subordinated Tier 2 capital notes, due March 2031 | **300.0** | – |
| Fixed-to-floating rate callable subordinated Tier 2 capital notes, due May 2026 | **–** | 385.0 |
| Unamortised discount | **–** | (0.1) |
| Accrued interest | **0.1** | 3.4 |
| Fair value hedge accounting adjustment (note 21) | **(8.3)** | 3.0 |
| **Total subordinated liabilities** | **291.8** | 391.3 |

In March 2021, TSB Banking Group plc issued £300.0 million fixed-to-floating rate callable subordinated Tier 2 capital notes, due to mature in March 2031, to its parent company, Banco de Sabadell, S.A. These were issued at a price of 100% of the principal amount. The notes pay interest at a fixed rate of 3.449% per annum payable quarterly in arrears until March 2031 at which time the interest rate becomes SONIA plus 3.05% per annum payable quarterly in arrears. The Company has the option to redeem these notes in March 2026, subject to approval of the PRA.

In May 2021, TSB Banking Group plc exercised its early call option over £385.0 million of fixed-to-floating rate callable subordinated Tier 2 capital notes. Prior to their redemption, the notes paid interest at a rate of 5.75% per annum, payable semi-annually in arrears.

### 4. Other financial liabilities

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Items in the course of transmission to credit institutions | **44.0** | 41.7 |
| Items in the course of transmission to non-credit institutions | **4.6** | 7.3 |
| Collateral placed at central clearing houses | **143.6** | 2.6 |
| Collateral placed with credit institutions | **2.1** | – |
| **Total other financial liabilities** | **194.3** | 51.6 |

### 5. Fair value of financial liabilities

The following table summarises the carrying values, fair values, and valuation hierarchy, of financial liabilities. The fair values presented in the table are at a specific date and may be significantly different from the amount which will actually be paid on the maturity or settlement date.

| | Level 1 £ million | Level 2 £ million | Level 3 £ million | Total fair value £ million | Total carrying value £ million |
|---|---|---|---|---|---|
| **At 31 December 2021** | | | | | |
| Customer deposits | **–** | **35,952.4** | **–** | **35,952.4** | **35,951.9** |
| Debt securities in issue | **1,762.5** | **451.9** | **–** | **2,214.4** | **2,199.1** |
| Subordinated liabilities | **–** | **299.8** | **–** | **299.8** | **291.8** |
| Derivative liabilities at fair value through profit or loss | **–** | **156.5** | **–** | **156.5** | **156.5** |
| Hedging derivative liabilities | **–** | **136.8** | **–** | **136.8** | **136.8** |
| | | | | | |
| **At 31 December 2020** | | | | | |
| Customer deposits | – | 34,405.2 | – | 34,405.2 | 34,375.3 |
| Debt securities in issue | 1,267.1 | 450.1 | – | 1,717.2 | 1,699.2 |
| Subordinated liabilities | – | 394.0 | – | 394.0 | 391.3 |
| Derivative liabilities at fair value through profit or loss | – | 302.3 | – | 302.3 | 302.3 |
| Hedging derivative liabilities | – | 225.2 | – | 225.2 | 225.2 |

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. When available, TSB measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. If a market for a financial instrument is not active, TSB establishes fair value using a valuation technique. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis.

# Notes to the consolidated financial statements

## Sources of funding (continued)

### 5. Fair value of financial liabilities (continued)

The fair value of customer deposits repayable on demand is considered to be equal to their carrying value given they are short term in nature. The fair value for all other customer deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities. TSB's subordinated liabilities and derivative financial liabilities are primarily valued using discounted cash flows where the most significant input is interest yield curves developed from publicly quoted rates and by reference to instruments with risk characteristics similar to those held by TSB. Derivative financial instruments are the only financial liabilities that are carried at fair value.

The carrying amount of borrowings from central banks, deposits from credit institutions, and other financial liabilities is a reasonable approximation of fair value as these balances are either on demand or variable rate and as such these amounts are considered as Level 2.

*Valuation hierarchy of financial instruments*
Financial instruments carried at fair value, or for which fair values are disclosed, have been classified into three levels according to the quality and reliability of information used to determine the fair values. There were no transfers between levels in 2021 or 2020.

**Level 1 -** Level 1 fair value measurements are those derived from unadjusted quoted prices in active markets for identical assets or liabilities.
**Level 2 -** Level 2 valuations are those where quoted market prices are not available, for example, where the instrument is traded in a market that is not considered to be active or valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.
**Level 3 -** Level 3 portfolios are those where at least one input which could have a significant effect on the instrument's valuation is not based on observable market data.

## Loans and liquid assets

**Funds deposited with TSB are primarily used to support lending to customers. TSB lends money to customers using different products, including mortgages, credit cards, unsecured personal loans and overdrafts. A portion of the funds are held in reserve – we call that our liquidity portfolio, which enables TSB to meet unexpected future funding requirements.**

**Accounting policies effective for the year ended December 2021**

### (b) Classification and measurement of financial assets

Financial assets is the term used to describe TSB's loans to customers and other institutions. It includes cash and balances with central banks and other demand deposits, reverse repurchase agreements, debt securities, loans and advances to customers, loans and advances to central banks and credit institutions, other advances, and derivative financial assets (see accounting policy (j) under Managing financial risk), and other advances. A financial asset is recognised on the balance sheet when the cash is advanced to the borrower, or in the case of purchases of debt securities, on the settlement date.

*Classification and measurement*

On initial recognition, financial assets are classified into one of three measurement categories, amortised cost, fair value through other comprehensive income, or fair value through profit or loss depending on TSB's business model for managing the financial assets and whether the cash flows represent solely payments of principal and interest.

TSB assesses its business models at a portfolio level based on its objectives for the relevant portfolio, how performance of the portfolio is measured and reported, how management are compensated, and the frequency and the reasons for asset sales from the portfolio. TSB reclassifies financial assets only when its business model for managing the portfolio of assets changes.

*Financial assets that are debt instruments measured at amortised cost*

Financial assets in portfolios where the business model is to hold the assets to collect the contractual cash flows and where those cash flows represent solely payments of principal and interest are measured at amortised cost. Cash flows are considered to represent solely payments of principal and interest where they are consistent with a basic lending arrangement. This includes all TSB's loans and advances to customers. Where the contractual cash flows introduce exposures to risk or volatility unrelated to a basic lending arrangement, such as from changes in equity prices, the cash flows are not considered to be solely payments of principal and interest. TSB has no such financial instruments.

Financial assets measured at amortised cost are initially recognised when the cash is advanced to the borrower at fair value including transaction costs. Subsequent measurement is at amortised cost, using the effective interest rate method. Amortised cost is the amount at which a financial asset is initially recognised, minus principal repayments, plus or minus the unamortised amount of any difference between the initial amount recognised and the maturity amount, calculated using the effective interest rate method. The carrying amount of these assets is adjusted by an expected credit loss allowance.

*Financial assets that are debt instruments measured at fair value through other comprehensive income (FVOCI)*

Financial assets in portfolios where the business model is to hold the assets to collect the contractual cash flows and to generate cash flows from selling assets are measured at fair value including transaction costs. Where the cash flows represent solely payments of principal and interest, gains and losses arising from changes in fair value are recognised directly in other comprehensive income. When the financial asset is either sold or matures, the cumulative gain or loss previously recognised in other comprehensive income is recognised in the income statement. Interest income is calculated using the effective interest method and is recognised in the income statement in net interest income. Foreign exchange gains and losses on financial assets denominated in foreign currencies are recognised in the income statement in exchange gains or losses. Impairment losses are recognised in the income statement.

*Financial assets measured at fair value through profit or loss (FVPL)*

Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at fair value on initial recognition and subsequently. Fair value gains and losses are recognised in the income statement within other income. Derivative financial assets are measured at FVPL (see accounting policy (j) under Managing financial risk). All equity instruments are measured at FVPL with dividends continuing to be recognised in other income in the income statement.

## Loans and liquid assets (continued)

**Accounting policies effective for the year ended December 2021 (continued)**

**(c) Impairment of financial assets**

The impairment requirements of IFRS 9 apply to financial assets measured at amortised cost and debt instruments measured at FVOCI. At initial recognition, an impairment allowance is required for expected credit losses (ECL) resulting from default events expected within the next 12 months (12 month ECL). In the event of a significant increase in credit risk, allowance is required for ECL resulting from default events expected over the estimated life of the financial instrument (lifetime ECL). IFRS 9 requires the financial asset to be allocated to one of the following three 'stages':

- Stage 1 - Financial assets which have not experienced a significant increase in credit risk since they were originated. Recognition of a 12 month ECL is required. Interest income on stage 1 financial assets is calculated on the gross carrying amount of the financial asset;
- Stage 2 – Financial assets which have experienced a significant increase in credit risk since initial recognition. For financial assets in stage 2, recognition of a lifetime ECL impairment allowance is required. Interest income on stage 2 financial assets is calculated on the gross carrying amount of the financial asset; and
- Stage 3 - Financial assets which have experienced one or more events that have had a detrimental impact on the estimated future cash flows and are considered to be credit impaired. Like stage 2, recognition of a lifetime expected ECL impairment allowance is required. However, interest income on stage 3 loans is calculated on the financial asset balance net of the impairment allowance.

Financial assets that are credit impaired at the date of their purchase or origination will be reported in a separate 'purchased or originated as credit impaired' (POCI) category until the loan is derecognised. The cumulative change in lifetime expected credit loss since the purchase or origination of the financial asset is recognised as a loss allowance.

*Definition of default for IFRS 9*

Loans and advances that are more than 90 days past due, or considered by management as unlikely to pay their obligations, are considered, for IFRS 9 purposes, to be in default, non performing, and credit impaired (stage 3). Examples of loans considered unlikely to pay include customers in bankruptcy or subject to an individual voluntary arrangement, customers undergoing repossession, and customers who have received a forbearance treatment, generally within the previous two years, and have subsequently either moved back in to early arrears or have received an additional forbearance measure. Customers who have cured but who were 90 days past due, or considered unlikely to pay, in the previous six months are also considered to remain in default and classified as credit impaired. TSB policy is not to rebut the presumption in IFRS 9 that loans which are more than 90 days past due are in default. Effective from 1 January 2021, TSB changed the regulatory definition of default for secured portfolios to include loans that are more than 90 days past due (previously the regulatory capital definition was 180 days). While there was no change to the IFRS 9 definition of default, nor to the measurement of ECL, this better aligned the default definition for regulatory capital with that of IFRS 9.

*Grouping of financial assets for credit impairment losses measured on a collective basis*

Expected credit losses are assessed and measured on a collective basis for homogenous groups where the financial assets within that group share similar credit risk characteristics. Given the predominantly retail nature of TSB's loans, groupings are determined using product type, such as secured (retail), unsecured, and business banking exposures. The appropriateness of the groupings is monitored and reviewed on a periodic basis. TSB does not currently assess any material exposures on an individual basis.

*Significant increase in credit risk*

Financial assets are considered to be in stage 2 when their credit risk has increased significantly since initial recognition. The main factor that is considered by TSB is an increase in the residual lifetime Probability of Default (PD) since initial recognition. A loan will be considered to have experienced a significant increase in credit risk, and be transferred from stage 1 to stage 2 if the residual lifetime PD has increased by a factor of 2 times the origination PD and the increase is between 10bps and 410bps (for different cohorts of secured retail), between 250bps and 770bps for unsecured products, and more than 50bps for business banking assets. As a secondary qualitative assessment criterion, financial assets that are in forbearance but not credit impaired are considered to have experienced significant increase in credit risk and will be in stage 2. As a backstop, TSB does not rebut the presumption in IFRS 9 that all financial assets that are more than 30 days past due have experienced a significant increase in credit risk. Consequently, in respect of loans and advances to customers, TSB does not use the practical expedient in IFRS 9 which permits low credit risk loans (i.e. those considered investment grade) to remain in stage 1 without an assessment of significant increase ('low credit risk exemption').

However, in respect of all other categories of financial assets at amortised cost and financial assets at fair value through other comprehensive income, TSB uses the low credit risk exemption and categorises these financial assets as stage 1.

*Credit Impaired (stage 3)*

Financial assets are considered to be credit impaired and included in stage 3 when there is objective evidence of credit impairment which is consistent with the definition of default for IFRS 9 as described above.

# Notes to the consolidated financial statements

## Loans and liquid assets (continued)

**Accounting policies effective for the year ended December 2021 (continued)**

**(c) Impairment of financial assets** (continued)

*Purchased or originated credit impaired (POCI)*
Financial assets that are credit impaired at the date of their purchase or origination will be reported in a separate POCI category. For such assets, lifetime ECL are incorporated into the calculation of the effective interest rate on initial recognition. Consequently, POCI assets do not carry an impairment allowance on initial recognition. The amount recognised as a loss subsequent to initial recognition is equal to the change in lifetime ECL since initial recognition of the asset. Subsequent to origination, POCI financial assets that no longer meet the stage 3 criteria will no longer be considered to be credit impaired but will continue to be reported as POCI.

*Write offs*
A loan or advance is normally written off, either partially or in full, against the related allowance when the proceeds from realising any available security have been received or there is no realistic prospect of recovery (as a result of the customer's insolvency, ceasing to trade or other reason) and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of impairment losses recorded in the statement of comprehensive income. Financial assets that are written off could still be subject to enforcement activities in order to comply with TSB's procedures for recovery of amounts due. In the event of significant improvements in expected recoveries on stage 3 assets, impairment reversals are recognised as a credit to impairment losses in the statement of comprehensive income.

*Modified financial assets and derecognition*
A financial asset that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement made on substantially different terms. Where the contractual cash flows of a financial asset have been modified and the financial asset was not derecognised, its gross carrying amount is recalculated as the present value of the modified contractual cash flows, discounted at the original effective interest rate with a gain or loss recognised in the income statement. The contractual terms of a loan may be modified for a number of reasons, primarily due to customers being granted a concession due to their financial difficulty and the loan being considered in forbearance.

*Methodology for measuring expected credit losses*
The allowance for ECLs is calculated using three main components: a probability of default (PD), a loss given default (LGD); and the exposure at default (EAD). For accounting purposes, the 12 month and lifetime PDs represent the probability of a default occurring over the next 12 months or the lifetime of the financial instruments, respectively, based on conditions existing at the balance sheet date and expected future economic conditions that affect credit risk.

The LGD represents losses expected on default, taking into account the mitigating effect of collateral, its expected value when realised and the time value of money and is discounted using the effective interest rate. The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdown of a committed facility.

ECL is calculated by multiplying the PD (12 month or lifetime depending on the staging of the loan), LGD and EAD. In respect of TSB's mortgages and unsecured personal loans, ECL is calculated from the initial recognition of the loan for the maximum period that TSB is exposed to credit risk which takes into account expected customer repayment behaviour. In respect of revolving loans, such as overdrafts and credit cards, TSB's exposure to credit risk is not limited to the contractual period and the expected life is calculated based on the estimated behavioural life of the loan and associated undrawn facility which is currently ten years. The measurement of ECL also takes into account all reasonable and supportable information, including forward looking economic scenarios to calculate a probability weighted forward looking estimate.

**(d) Derecognition of financial assets**
Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when TSB has transferred its contractual right to receive the cash flows from the assets and either (i) substantially all of the risks and rewards of ownership have been transferred; or (ii) TSB has neither retained nor transferred substantially all of the risks and rewards but has transferred control.

Where TSB enters into securitisation transactions to finance certain loans and advances to customers using a structured entity funded by the issue of debt, these loans and advances continue to be recognised, as TSB has not transferred substantially all the risks and rewards. A corresponding liability for the funding is also recognised.

Financial instruments sold under a repurchase agreement, under which substantially all the risks and rewards of ownership are retained by TSB, continue to be recognised on the balance sheet and the sale proceeds are recognised as a financial liability. The difference between the sale and repurchase price is recognised over the life of the agreement as interest expense using the effective interest method.

## Loans and liquid assets (continued)

### 6. Debt securities

| Fair value through other comprehensive income (FVOCI) | 2021 £ million | 2020 £ million |
|---|---|---|
| UK Gilts | **1,069.0** | 1,405.4 |
| Supranational and development bank bonds | **–** | 91.5 |
| **Total debt securities at FVOCI** | **1,069.0** | 1,496.9 |

| Amortised cost | 2021 £ million | 2020 £ million |
|---|---|---|
| UK Gilts | **1,614.3** | 555.3 |
| Supranational and development bank bonds | **339.0** | 356.9 |
| Covered bonds | **213.4** | 211.5 |
| **Total debt securities at amortised cost** | **2,166.7** | 1,123.7 |

Debt securities of £1,069.0 million (2020: £1,496.9 million) are held as part of the liquid asset portfolio, where the business model is to hold the assets to collect the contractual cash flows and to generate cash flows from selling the assets. These assets are carried at FVOCI.

Debt securities of £2,166.7 million (2020: £1,123.7 million) are held as part of a second, separate liquid asset portfolio, where the business model is solely to hold the assets to collect the contractual cash flows. These assets are carried at amortised cost.

At 31 December 2020, UK gilts at FVOCI with a carrying value of £225.8 million were subject to repurchase agreements. Not such amounts were present at December 2021. In addition, £257.5 million of debt securities at amortised cost had been pledged as collateral (2020: £190.1 million).

### 7. Loans and advances to central banks and credit institutions

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Loans and advances to central banks | **143.6** | 120.9 |
| Loans and advances to credit institutions: | | |
| Cash deposits held | **56.1** | 43.3 |
| **Total** | **199.7** | 164.2 |

Loans and advances to central banks represent mandatory deposits at the Bank of England. Restricted cash deposits are held in respect of TSB's covered bond programme.

# Notes to the consolidated financial statements

## Loans and liquid assets (continued)

### 8. Loans and advances to customers and allowance for credit impairment losses

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Secured (retail) | **34,833.8** | 30,790.4 |
| Unsecured portfolios | **1,990.6** | 1,992.7 |
| Business banking | **667.2** | 715.3 |
| | **37,491.6** | 33,498.4 |
| Allowance for credit impairment losses (note 18) | **(189.6)** | (239.0) |
| **Net customer lending balances** | **37,302.0** | 33,259.4 |
| Valuation adjustments[(1)] | **81.8** | 58.5 |
| **Loans and advances to customers** | **37,383.8** | 33,317.9 |

(1) Comprises accrued interest of £17.4 million (2020: £19.1 million) and effective interest rate adjustments of £64.4 million (2020: £39.4 million).

In the normal course of business, TSB provides commitments to lend to its customers as presented below.

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Credit cards | **3,038.7** | 2,956.9 |
| Mortgage offers made | **2,316.6** | 2,164.1 |
| Current accounts and other lending | **1,112.1** | 1,130.5 |
| **Total commitments** | **6,467.4** | 6,251.5 |

The credit impairment provision in respect of total loan commitments is shown in note 29 on page 110.

**Significant estimates - measurement uncertainty and sensitivity of allowance for credit impairment losses**
The measurement of the allowance for credit impairment losses is complex and involves the use of significant judgement and estimation uncertainty as follows:

- Estimation uncertainty from the use of multiple forward-looking economic scenarios and associated probability weightings;
- Judgements required to adjust modelled outcomes to reflect where they are not considered to fully capture expected credit losses (referred to as post model adjustments or PMAs); and
- Judgements required to assess when a financial asset has experienced a significant increase in credit risk.

*Forward looking economic scenarios*
TSB currently uses five economic scenarios (2020: four scenarios), representative of management's view of forecast economic conditions. During 2021, the number of scenarios was increased from four to five, with an additional severe downside scenario added to reflect increasing inflationary pressures. Key scenario assumptions are set internally for GDP, house prices, unemployment and interest rates. The forecast for these metrics is compared with data published by the Bank of England and other external sources to ensure the scenarios are free from bias and reflect independent external information.

Severe downside scenarios, when considered appropriate, are typically aligned with those used for ICAAP purposes and are considered to be tail risk scenarios and are used to capture non-linearity in expected credit losses. This is where the relationship of credit losses to the relevant economic variables which influence credit losses (e.g. house prices or unemployment) is such that each unit of change in an economic variable does not lead to a uniform change in expected credit losses. For example, credit losses in secured portfolios may remain subdued in an environment where house prices exhibit only a small decrease. However, after a certain level of house price fall credit losses would be forecast to increase more meaningfully where collateral values fall below the level of the customer loan.

Scenarios and associated weightings are reviewed monthly by an internal forum and updated, as necessary, to enable significant developments to be taken into account in measuring credit impairment provisions. The scenarios and weightings are presented quarterly for review and approval for use by the Audit Committee.

# Notes to the consolidated financial statements

## Loans and liquid assets (continued)

### 8. Loans and advances to customers and allowance for credit impairment losses (continued)

*Forward looking economic scenarios (continued)*
The five scenarios, together with the weightings applied at December 2021, are described below.

*Base case scenario: Cautious recovery following the COVID-19 economic 'shock' in 2020*

- The recovery in GDP that commenced in 2021 continues with a return to pre-pandemic levels in early 2022. Interest rates rise but remain low by historic standards. Inflation returns to its 2% target following an overshoot in 2022 and 2023. Unemployment is assumed to be at the high point of the forecast period at the end of 2021, following the end of the furlough scheme, but is assumed to fall back to 4.1% by the end of 2023. House prices decline in early 2022, following the end of the stamp duty holiday but resume a gentle upward trajectory thereafter.

  The base scenario is less pessimistic than the base scenario used in 2020 with a lower peak in unemployment of 5.5% (2020: 7.3%) and a lower peak to trough house price fall of 4% (2020: 12%).

*Upside: A benign reflation*

- Pandemic-related headwinds ease more quickly than in the base case scenario, and the economy is boosted by supportive fiscal and monetary policies. Unemployment falls more quickly than the base case due to the stronger recovery and faster productivity improvements. The BoE increases its base rate from early 2022, though rates remain low by historic standards.

*Downside scenario: Renewed pandemic headwinds*

- Another wave of the pandemic weighs heavily on the recovery in 2022. Unemployment rises relative to the base case, peaking at 7.0% in the middle of 2022. This triggers a moderate correction in house prices which experience a peak to trough fall of 18%. Against this backdrop, the BoE holds off on rate hikes until 2026.

*Severe downside (low interest rate) scenario: Uncontrolled pandemic*

- A vaccine-resistant variant emerges, which leads to severe instability in financial markets and another sharp downturn for the UK economy. GDP falls by 9.0% in the first quarter of 2022, and the unemployment rate rises quickly to a peak of 11.9% by the end of 2022. House prices fall sharply, with a peak to trough fall of 34%. In response, the BoE takes its base rate into negative territory, to (0.1)%, for the first time. However, the downturn is short-lived and followed by an extremely strong GDP rebound.

*Severe downside (high interest rate) scenario: Prolonged stagflation*

- Inflation surges in 2022, due to a variety of factors, including prolonged supply bottlenecks and labour shortages. Inflation expectations increase forcing the BoE to tighten policy significantly (with its base rate peaking at 3.25%). The economy enters another downturn without having fully recovered from the 2020 crisis. As a result, GDP fails to recover to pre-COVID-19 levels during the forecast period to 2026. Unemployment rises sharply, to a peak of 11.2% by the middle of 2023. Higher interest rates and rising unemployment lead to a 36% peak to trough decline in house prices.

The table below shows the weightings applied to each of the economic scenarios applied in measuring the allowance for credit impairment losses, together with ranges of the most sensitive inputs:

| **At 31 December 2021** | | **Base case** | **Upside** | **Downside** | **Severe downside (low rate)** | **Severe downside (High rate)** |
|---|---|---|---|---|---|---|
| Scenario weighting | | **50%** | **10%** | **30%** | **5%** | **5%** |
| GDP | Peak to trough fall | **n/a** | **n/a** | **(4.0)%** | **(9.0)%** | **(4.7)%** |
| Unemployment | Peak rate | **5.5%** | **5.5%** | **7.0%** | **11.9%** | **11.2%** |
| House prices | Peak-to-trough fall | **(4)%** | **(2)%** | **(18)%** | **(34)%** | **(36)%** |
| Interest rates | Most extreme rate(1) | **1.0%** | **1.5%** | **0.1%** | **(0.1)%** | **3.25%** |
| At 31 December 2020 | | | | | | |
| Scenario weighting | | 50% | 10% | 35% | 5% | n/a |
| GDP | Peak to trough fall | n/a | n/a | n/a | (0.4)% | n/a |
| Unemployment | Peak rate | 7.3% | 6.1% | 8.7% | 10.8% | n/a |
| House prices | Peak-to-trough fall | (12)% | (7)% | (15)% | (23)% | n/a |
| Interest rates | Most extreme rate(1) | 0.25% | 1.25% | 0.0% | 0.0% | n/a |

(1) The most extreme rate is the interest rate furthest from the current rate, either positive or negative during the forecast period.

Scenario weightings have remained consistent with the prior year. The combined weighting applied to downside scenarios has been maintained at 40% (2020: 40%). The emergence of heightened risks of higher inflation led to the inclusion of the low probability, high impact, prolonged stagflation scenario with a 5% weighting, with a corresponding reduction in the weighting applied to the downside scenario.

# Notes to the consolidated financial statements

## Loans and liquid assets (continued)

### 8. Loans and advances to customers and allowance for credit impairment losses (continued)

*Forward looking economic scenarios (continued)*

The table below sets out the key economic variables used in the scenarios, together with their weighted averages.

| Scenario | Weighting | Economic measure(1) | 2022 | 2023 | 2024 | 2025 | 2026 |
|---|---|---|---|---|---|---|---|
| | | | | | | | At 31 December 2021 |
| Upside | 10% | GDP | 6.3 % | 2.8 % | 1.6 % | 1.6 % | 1.6 % |
| | | Unemployment | 3.5 % | 3.5 % | 3.5 % | 3.5 % | 3.5 % |
| | | House prices | 3.2 % | 4.3 % | 2.6 % | 2.5 % | 2.5 % |
| | | Interest rates | 0.75 % | 1.25 % | 1.5 % | 1.5 % | 1.5 % |
| Base | 50% | GDP | 4.8 % | 1.5 % | 1.4 % | 1.4 % | 1.4 % |
| | | Unemployment | 4.8 % | 4.1 % | 4.0 % | 4.0 % | 4.0 % |
| | | House prices | (2.8)% | 2.4 % | 2.5 % | 2.5 % | 2.5 % |
| | | Interest rates | 0.5 % | 0.75 % | 0.75 % | 0.75 % | 1.0 % |
| Downside | 30% | GDP | 1.3 % | 2.4 % | 1.2 % | 1.2 % | 1.2 % |
| | | Unemployment | 6.7 % | 5.6 % | 4.7 % | 4.5 % | 4.5 % |
| | | House prices | (14.3)% | 0.8 % | 10.9 % | 5.0 % | 4.2 % |
| | | Interest rates | 0.1 % | 0.1 % | 0.1 % | 0.1 % | 0.25 % |
| Severe downside (Low rate) | 5% | GDP | (0.4)% | 10.0 % | 4.3 % | 2.1 % | 1.5 % |
| | | Unemployment | 11.9 % | 10.0 % | 6.6 % | 5.0 % | 4.8 % |
| | | House prices | (25.9)% | (1.3)% | 22.3 % | 7.9 % | 6.0 % |
| | | Interest rates | (0.1)% | (0.1)% | (0.1)% | 0 % | 0.1 % |
| Severe downside (High rate) | 5% | GDP | (1.4)% | 0 % | 1.3 % | 1.4 % | 1.4 % |
| | | Unemployment | 10.3 % | 11.2 % | 10.2 % | 9.1 % | 8.1 % |
| | | House prices | (25.9)% | (12.6)% | 8.6 % | 10.0 % | 10.0 % |
| | | Interest rates | 3.25 % | 3.25 % | 3.0 % | 2.5 % | 2.0 % |
| Weighted average | n/a | GDP | 3.3 % | 2.3 % | 1.5 % | 1.4 % | 1.4 % |
| | | Unemployment | 5.9 % | 5.1 % | 4.6 % | 4.4 % | 4.3 % |
| | | House prices | (8.0)% | 1.2 % | 6.3 % | 3.9 % | 3.6 % |
| | | Interest rates | 0.5 % | 0.7 % | 0.7 % | 0.7 % | 0.8 % |

| Scenario | Weighting | Economic measure(1) | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|---|
| | | | | | | | At 31 December 2020 |
| Upside | 10% | GDP | 9.3 % | 6.7 % | 1.7 % | 1.6 % | 1.6 % |
| | | Unemployment | 4.3 % | 3.4 % | 3.3 % | 3.3 % | 3.3 % |
| | | House prices | (5.8)% | 4.4 % | 4.8 % | 5.0 % | 3.6 % |
| | | Interest rates | 0.1 % | 0.25 % | 0.75 % | 1.25 % | 1.25 % |
| Base | 50% | GDP | 6.1 % | 5.8 % | 1.5 % | 1.4 % | 1.4 % |
| | | Unemployment | 6.8 % | 5.0 % | 4.5 % | 4.2 % | 4.0 % |
| | | House prices | (11.8)% | 7.3 % | 5.6 % | 5.0 % | 3.6 % |
| | | Interest rates | 0.1 % | 0.1 % | 0.1 % | 0.1 % | 0.25 % |
| Downside | 35% | GDP | 3.5 % | 4.9 % | 1.3 % | 1.4 % | 1.4 % |
| | | Unemployment | 8.0 % | 6.4 % | 5.6 % | 5.0 % | 5.0 % |
| | | House prices | (13.5)% | 3.1 % | 5.6 % | 5.0 % | 3.6 % |
| | | Interest rates | 0 % | 0 % | 0 % | 0 % | 0 % |
| Severe downside | 5% | GDP | 0.8 % | 3.6 % | 1.2 % | 1.4 % | 1.4 % |
| | | Unemployment | 9.3 % | 7.1 % | 6.5 % | 6.1 % | 5.6 % |
| | | House prices | (13.5)% | (10.3)% | 0 % | 0 % | 3.4 % |
| | | Interest rates | 0 % | 0 % | 0 % | 0 % | 0 % |
| Weighted average | n/a | GDP | 5.2 % | 5.5 % | 1.4 % | 1.4 % | 1.4 % |
| | | Unemployment | 7.0 % | 5.4 % | 4.9 % | 4.5 % | 4.4 % |
| | | House prices | (11.9)% | 4.7 % | 5.2 % | 4.8 % | 3.6 % |
| | | Interest rates | 0.1 % | 0.1 % | 0.1 % | 0.2 % | 0.25 % |

(1) GDP is presented as the annual change in forecast quarterly average GDP for each year. Unemployment rates are presented as the Q4 forecast for each year. House price changes are presented as the year-on-year change in Q4 forecast house prices in each year. Interest rates are Bank Rate in December each year.

Key variables in each of the scenarios are assumed to revert to a long term constant rate over a period of up to two years after the end of the forecast period. The reversionary rates used are as follows: GDP 1.5% (2020: 1.5%), unemployment 4.0% (2020: 4.0%); interest rates 1.0% (2020: 1.0%); and house price growth of 3.75% (2020: 3.75%) per annum.

## Loans and liquid assets (continued)

### 8. Loans and advances to customers and allowance for credit impairment losses (continued)

*Sensitivity to alternative economic scenario weightings*

The calculation of the allowance for credit impairment losses is sensitive to changes in the chosen weightings. The table below summarises the impact on the allowance for credit impairment losses from the use of alternative scenario weightings.

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Allowance for credit losses | **189.6** | 239.0 |
| Provision for off balance sheet exposures (note 29) | **16.7** | 19.2 |
| **Combined on and off balance sheet - using weighted forecast** | **206.3** | 258.2 |
| | | |
| **Increase/(decrease) if a 100% weighting was applied to each scenario:** | | |
| Upside | **(39.8)** | (50.0) |
| Base case | **(28.3)** | (23.0) |
| Downside | **5.1** | 33.0 |
| Severe downside – low interest rate | **252.6** | 177.0 |
| Severe downside – high interest rate | **278.5** | n/a |
| | | |
| **Proportion of gross loan balance in stage 2:** | | |
| Reported – using weighted forecast | **6.9%** | 9.6% |
| Upside | **6.4%** | 9.0% |
| Base case | **6.7%** | 9.7% |
| Downside | **7.3%** | 11.3% |
| Severe downside – low interest rate | **10.1%** | 13.5% |
| Severe downside – high interest rate | **24.5%** | n/a |

The ECL for each scenario multiplied by the scenario probability will not reconcile to the overall provision. Whilst the stage allocation of loans varies in each individual scenario, each loan is allocated to a single stage in the overall provision calculation based on a weighted average PD, taking into account the economic scenarios. A probability weighted 12 month or lifetime ECL (which takes into account the economic scenarios) is then calculated based on the stage allocation.

*Judgements required in assessing post model adjustments*

At 31 December 2021, the allowance of £189.6 million (2020: £239.0 million) included PMAs of £61.8 million (2020: £41.2 million) as shown in the table below:

| | Secured (retail) £ million | Unsecured £ million | Business Banking £ million | 2021 £ million | 2020 £ million |
|---|---|---|---|---|---|
| COVID-19 related (consumer behaviour) | **16.3** | **15.5** | **2.0** | **33.8** | 38.0 |
| Impairment default triggers | **10.5** | **(1.5)** | **0.3** | **9.3** | 14.7 |
| Model performance | **3.1** | **9.5** | **–** | **12.6** | 19.9 |
| Operational matters | **0.7** | **1.2** | **1.6** | **3.5** | 13.0 |
| Economic scenarios | **–** | **–** | **–** | **–** | (11.2) |
| Bounce Back Loan Scheme | **–** | **–** | **2.6** | **2.6** | (33.2) |
| **Total** | **30.6** | **24.7** | **6.5** | **61.8** | 41.2 |

The suite of methodologies used to calculate PMAs are grounded in similar principles to those adopted for the core impairment models, with the inputs and PMA methodologies subject to regular oversight and PMA outputs reviewed in a consistent manner to the output from the core impairment models. The key categories of PMAs are as follows:

*COVID-19 related (consumer behaviour)*

COVID-19 related PMAs capture the increased risk of credit losses arising from changes in consumer behaviour which may not have been appropriately captured when conditioning the impairment models. For example, circumstances, such as customer repayment holidays, static bureau data reporting, and associated exclusion from forbearance classifications, together with changes in customer spending patterns all result in atypical outcomes, when comparisons are made to equivalent metrics prior to the pandemic. This typically involves portfolio adjustments to risk grade or staging, to capture the underlying risk. The PMA is valued as the difference between modelled provision and the impact the portfolio adjustments would have on the provision. While COVID-19 support measures have come to an end, the PMA captures the ongoing risk of customer stress.

# Notes to the consolidated financial statements

## Loans and liquid assets (continued)

**8. Loans and advances to customers and allowance for credit impairment losses (continued)**

*Judgements required in assessing post model adjustments (continued)*

*Impairment default triggers*
- PMAs in this category capture the risk of default, where not fully captured in the model. A key contributor to the PMAs in this category captures the risk associated with interest only mortgage customers not making their final bullet payment at maturity. Defaults of this type are not included in the Probability of Default (PD) model, the impact of which is held as a PMA. In order to determine the value of the PMA, the default rate is determined by establishing the proportion of interest only accounts likely to exceed their mortgage term by 3 months without repaying their principal balance and the loss given default reflects house price projections as informed by the relevant economic scenarios.

*Model performance*
- PMAs are required to mitigate risks associated with model performance. An example of this is the requirement to capture the impact of significantly larger changes in GDP during the pandemic compared to those observed historically, against which modelled outcomes have been calibrated.

*Operational matters*
- PMAs are used to address the risk of certain operational matters. One of the most notable examples relates to certain customer accounts which require bespoke assessments of their underlying credit risk, for example, relating to mortgages on high value properties for which models have not been calibrated.

*Economic scenarios*
- The economic scenarios PMA in 2020 reflected late changes in economic scenarios that took account of Brexit negotiations.

*Bounce Back Loan Scheme*
- In 2020, a PMA was required to take account of the UK Government guarantee on Bounce Back Loans (BBLs). Models have been updated to capture the government guarantee in 2021 and, consequently, the PMA is no longer required.

*Judgements required in assessing significant increase in credit risk*
TSB’s policy for determining when a financial asset has experienced a significant increase in credit risk is explained on page 71. In applying this policy, the key judgement is the level of increase in the residual lifetime PD as compared to the equivalent position at the origination of the financial asset.

At 31 December 2021, secured (retail) loans were considered to have experienced a significant increase in credit risk (and classified in stage 2) if the residual lifetime PD had increased by a factor of 2 times the origination PD and the increase was also between 10bps and 410bps (2020: between 10bps and 410bps) dependent on the cohort of secured (retail) asset. For unsecured products, the threshold was 2 times the origination PD and where the increase was also between 250bps and 770bps (2020: 250bps-770bps) dependent on the type of unsecured product. For business banking assets, the threshold was 2 times the origination PD and where the increase was also more than 50bps (2020: 50bps).

In assessing the appropriateness of this judgement, management applied a framework that considers a number of quantitative factors, including the accuracy of the thresholds and their predictive ability. As a result of this assessment, no changes were required to the thresholds in 2021. In the light of analysis undertaken during 2020, changes in thresholds resulted in £578.6 million of gross loans being transferred from stage 2 to stage 1, together with the associated impairment allowance of £0.1 million.

Consistent with the COVID-19 related PMA described above, a PMA was applied to the modelled stage allocation of gross loans to capture the increased risk of credit losses arising from changes in consumer behaviour which have not been considered in conditioning the impairment models. This resulted in the transfer of £1,008.0 million (2020: £1,168.8 million) of gross loans from stage 1 to stage 2 and £9.6 million (2020: £24.3 million) from stage 1 to stage 3. Related allowances of £15.3 million (2020: £13.3 million) were transferred from stage 1 to stage 2 and £nil (2020: £2.6 million) from stage 1 to stage 3.

# Notes to the consolidated financial statements

## Loans and liquid assets (continued)

### 9. Other advances

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Items in the course of collection from credit institutions | **17.7** | 21.7 |
| Items in the course of collection from non-credit institutions | **12.9** | 2.8 |
| Collateral placed at central clearing houses | **21.5** | 190.8 |
| Collateral placed with credit institutions | **0.1** | 4.9 |
| Amounts due from the British Business Bank | **28.5** | – |
| **Total other advances** | **80.7** | 220.2 |

Amounts due from the British Business Bank are in respect of the Bounce Back Loan Scheme. These reflect recovery of loan balances previously charged off and customer interest which are recoverable under a guarantee from the British Busines Bank.

### 10. Fair value of financial assets

The following table summarises the carrying values, fair values, and valuation hierarchy of financial assets presented on TSB's consolidated balance sheet. The fair values presented are at a specific date and may be significantly different from the amount which will actually be received on the maturity or settlement date.

| | Level 1 £ million | Level 2 £ million | Level 3 £ million | Total fair value £ million | Total carrying value £ million |
|---|---|---|---|---|---|
| **At 31 December 2021** | | | | | |
| Debt securities at amortised cost | **2,164.1** | **30.0** | **–** | **2,194.1** | **2,166.7** |
| Loans and advances to customers | **–** | **–** | **37,644.1** | **37,644.1** | **37,383.8** |
| Financial assets at fair value through other comprehensive income | **1,069.0** | **–** | **–** | **1,069.0** | **1,069.0** |
| Derivative assets at fair value through profit or loss | **–** | **169.3** | **–** | **169.3** | **169.3** |
| Hedging derivative assets | **–** | **244.5** | **–** | **244.5** | **244.5** |
| | | | | | |
| **At 31 December 2020** | | | | | |
| Debt securities at amortised cost | 1,127.9 | – | – | 1,127.9 | 1,123.7 |
| Loans and advances to customers | – | – | 33,315.0 | 33,315.0 | 33,317.9 |
| Financial assets at fair value through other comprehensive income | 1,496.9 | – | – | 1,496.9 | 1,496.9 |
| Derivative assets at fair value through profit or loss | – | 198.3 | – | 198.3 | 198.3 |
| Hedging derivative assets | – | 139.9 | – | 139.9 | 139.9 |

A description of the fair value levels is included in note 5. Debt securities at amortised cost and financial assets at fair value through other comprehensive income are generally valued using quoted market prices and are therefore classified as Level 1 assets. Derivative financial assets are primarily collateralised interest rate swaps and are valued using a discounted cash flow model where the most significant input is interest yield curves which are developed from publicly quoted SONIA rates. As such, derivative financial instruments are classified as Level 2 assets.

TSB provides loans at both fixed and variable rates. Fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by TSB and other financial institutions. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period.

Cash, cash balances at central banks and other demand deposits; loans and advances to central banks; loans and advances to credit institutions and other advances are generally short term in nature and to counterparties with a high credit quality and the carrying amount is a reasonable approximation of fair value. As such these amounts are considered as Level 2.

# Notes to the consolidated financial statements

## Income

**We earn income in the form of interest that we receive on the loans we make to customers and from our liquidity portfolio and we pay interest to savings and bank account customers on the money they deposit with us and to providers of other forms of funding. We also earn other income in the form of fees and charges from the provision of banking services and commissions from the sale of certain third party products such as general insurance.**

**Accounting policies relevant to recognising income**

**(e) Interest income and expense**

*Financial instruments classified as amortised cost and fair value through other comprehensive income*
Interest income and expense are recognised in the income statement for all interest-bearing financial instruments using the EIR method. The EIR method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense. The EIR is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability.

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by TSB that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Reversionary interest is not included in the assessment of the effective interest rate on secured products. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss (see accounting policy (c) on impairment of financial assets).

For financial assets, interest income is calculated by applying the effective interest rate to the gross carrying amount of the financial asset. There are two exceptions to this as follows:

(i) Interest income in respect of financial assets that have become credit impaired (stage 3) subsequent to their initial recognition is calculated by applying the effective interest rate to their amortised cost, net of expected loss provision; and

(ii) Interest income in respect of financial assets classified as POCI is calculated by applying the original credit adjusted effective interest rate to the amortised cost of the financial asset.

*Derivative financial instruments*
Interest income and expense on derivative financial instruments in qualifying hedge accounting relationships, where the hedged item is a financial asset, is recognised in interest income. Where the hedged item is a financial liability, the derivative interest income or expense is recognised in interest expense. Interest income and expense on derivatives classified as held for trading is recognised in interest income.

**(f) Other operating income**
Other operating income, including fees and commissions, which are not an integral part of the EIR are generally recognised over time as the service is provided and TSB satisfies its performance obligations.

Renewal commission income is recognised when TSB satisfies its performance obligations under the relevant contract and management concludes that there is a high probability that there will be no significant reversal of the estimated income.

# Notes to the consolidated financial statements

## Income (continued)

### 11. Net interest income

| Interest and similar income | 2021 £ million | 2020 £ million |
|---|---|---|
| Interest income calculated using the effective interest method: | | |
| Cash, cash balances at central banks and other demand deposits | **3.9** | 9.8 |
| Financial assets at fair value through other comprehensive income | **9.5** | 15.1 |
| Debt securities at amortised cost | **16.7** | 7.6 |
| Loans to credit institutions | **–** | 0.5 |
| Loans and advances to customers | **916.3** | 889.0 |
| | **946.4** | 922.0 |
| Derivative financial instruments | **(35.0)** | (41.0) |
| **Total interest and similar income** | **911.4** | 881.0 |
| | | |
| **Interest and similar expense** | | |
| Interest expense calculated using the effective interest method: | | |
| Borrowings from central banks | **(8.6)** | (9.5) |
| Deposits from credit institutions | **(0.1)** | (0.1) |
| Customer deposits | **(29.2)** | (74.7) |
| Debt securities in issue | **(20.9)** | (13.8) |
| Subordinated liabilities | **(15.6)** | (22.4) |
| Lease liabilities | **(2.6)** | (1.3) |
| Provisions | **(0.9)** | – |
| | **(77.9)** | (121.8) |
| Derivative financial instruments | **35.4** | 27.2 |
| **Total interest and similar expense** | **(42.5)** | (94.6) |
| **Net interest income** | **868.9** | 786.4 |

Included within interest and similar income is £16.2 million (2020: £15.9 million) in respect of impaired financial assets.

### 12. Net fee and commission income

| | 2021 £ million | 2020 £ million(1) |
|---|---|---|
| **Fee and commission income** | | |
| Bank accounts | **53.4** | 44.2 |
| Credit and debit card fee income | **44.4** | 37.2 |
| Insurance commission income | **9.1** | 9.2 |
| Other | **14.9** | 14.0 |
| | **121.8** | 104.6 |
| **Fee and commission expense** | | |
| Bank accounts | **(1.5)** | (1.7) |
| Credit and debit card fee expense | **–** | (1.4) |
| Other | **(16.7)** | (15.6) |
| | **(18.2)** | (18.7) |
| **Net fee and commission income** | **103.6** | 85.9 |

(1) Comparative information for 2020 has been reclassified to align with the current year presentation which has resulted in a reduction in fee and commission income of £17.8 million, comprising credit and debit card fee income £18.2 million and Bank accounts £(0.4) million. This was offset by a corresponding reduction in fee and commission expense (Bank accounts) of £17.8 million. There was no change to net fee and commission income previously presented.

### 13. Other operating income

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Migration related income (1) | **10.3** | 35.1 |
| Rental income | **0.5** | 0.6 |
| Other income | **0.1** | 2.1 |
| **Total other operating income** | **10.9** | 37.8 |

(1) Migration related income comprises insurance recoveries of post migration losses of £10.3 million (2020: £17.5 million) and migration related income from Lloyds Banking Group of £nil (2020: £17.6 million).

## Charges

**Running a bank with 5 million customers comes with overheads. Charges we incur include the costs of paying our employees, running our branches, investing in our business, paying for advertising and marketing. Occasionally, our customers' circumstances change and they are expected to be unable to repay the money they borrow from us causing us to incur impairment losses. Finally, TSB complies with its tax obligations to HMRC.**

**Accounting policies relevant to recognising charges**

**(g) Pensions and other post-retirement benefits**
TSB operates defined contribution pension plans under which fixed contributions are paid. The costs of TSB's defined contribution plans are charged to the income statement, as an operating expense, in the period in which they fall due.

**(h) Share based compensation**
TSB operates a number of cash settled share based compensation plans, in respect of services received from certain of its employees. The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. A corresponding credit is recognised as a liability. In addition, in some circumstances employees may provide services in advance of the grant date and therefore the liability is estimated for the purposes of recognising the expense during the period between service commencement period and grant date.

At the end of each reporting period, the fair value of the liability is measured with any changes in fair value recognised in operating expenses.

**(i) Taxation**
Current corporation tax which is payable or receivable on taxable profits or losses is recognised as tax expense or credit in the period in which the profits or losses arise.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements.

Deferred tax is determined using tax rates that have been enacted or substantively enacted by the balance sheet date that are expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled.

Deferred tax assets are recognised where it is probable that future taxable profits will be available against which the temporary differences can be utilised.

Deferred and current tax assets and liabilities are offset when they arise in the same tax reporting group and where there is both a legal right of offset and the intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

# Notes to the consolidated financial statements

## Charges (continued)

### 14. Operating expenses

| | 2021 £ million | 2020 £ million |
|---|---|---|
| **Staff costs** | | |
| Wages and salaries | **238.7** | 239.8 |
| Social security costs | **26.3** | 25.7 |
| Other pension costs | **31.6** | 32.1 |
| Severance costs | **8.6** | 45.1 |
| Other staff costs | **7.2** | 6.3 |
| **Total staff costs** | **312.4** | 349.0 |
| | | |
| **Premises expenses** | | |
| Rent | **1.7** | 7.3 |
| Rates, maintenance and other premises expenses | **43.0** | 63.4 |
| **Total premises expenses** | **44.7** | 70.7 |
| | | |
| **Other expenses** | | |
| IT servicing and licence costs | **222.6** | 231.7 |
| Regulatory, legal and consultancy costs | **42.5** | 58.9 |
| Collection and recovery conduct charges | **2.2** | 55.0 |
| Marketing | **36.1** | 42.3 |
| Other expenses (1) | **96.7** | 87.5 |
| **Total other expenses** | **400.1** | 475.4 |
| | | |
| Depreciation of property and equipment | **37.4** | 41.8 |
| Depreciation of right of use asset | **25.1** | 25.8 |
| Amortisation of intangible assets | **7.7** | 6.7 |
| **Total operating expenses** | **827.4** | 969.4 |

(1) Other expenses primarily comprise of the costs of various operational contracts, costs of non-staff contractors, fraud and operational losses.

Included in the above table are restructuring and other one off costs of £26.5 million (2020: £89.1 million) which are analysed by cost category in the table below. These primarily relate to costs of a multi-year branch restructuring and head office reorganisation programme that, since it commenced in 2019, has included the closure of 316 branches.

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Staff costs | **9.0** | 46.2 |
| Premises expenses | **(3.0)** | 21.1 |
| Other expenses | **3.3** | 4.9 |
| Depreciation | **17.2** | 16.9 |
| **Total restructuring and other one off costs** | **26.5** | 89.1 |

The monthly average number of employees on a headcount basis during the year was 6,137 (2020: 7,068), all of whom were employed in the UK. Remuneration paid to key management personnel (note 24(i)) is included in staff costs.

*Share based compensation*
Staff costs include £1.8 million (2020: £2.7 million) in respect of share based compensation arrangements. Such arrangements are limited to the operation of a Share Incentive Plan (SIP) which provide employees with the opportunity to own shares in Sabadell and the granting, where relevant, of shares to certain senior employees as part of their recruitment arrangements.

As all share based compensation arrangements involve an award of Sabadell shares, where TSB retains the obligation to settle, these arrangements are accounted for as cash settled share based payment arrangements resulting in the recognition of a liability. This liability is remeasured monthly, with changes recognised in operating expenses, to reflect the latest Sabadell share price and the estimated number of shares expected to vest. At 31 December 2021, £5.3 million (2020: £4.1 million) was recognised in respect of share based payment liabilities. An explanation of the instruments transacted to economically hedge TSB's exposure to share based payment liabilities is set out in note 24(ii) on page 108.

# Notes to the consolidated financial statements

## Charges (continued)

### 14. Operating expenses (continued)

*Fees payable to the external auditor*
Included in other expenses are fees payable to TSB's auditors, excluding VAT, as set out in the table below:

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Fees payable to the Company's auditor for the audit of the Company's annual accounts | **0.2** | 0.2 |
| Fees payable to the Company's auditor and its associates for other services: | | |
| Audit of the accounts of subsidiaries (1) | **3.0** | 2.6 |
| Audit related assurance services (2) | **1.5** | 1.1 |
| Other non audit services | **0.1** | – |
| **Total fees payable to TSB's auditors** | **4.8** | 3.9 |

(1) Additional fees of £0.3 million were incurred in 2021 relating to the 2020 audit and are not captured in the above table.
(2) Fees payable to the Company's auditor for the audit of the half year financial statements, as required by TSB's parent, Sabadell.

### 15. Directors' emoluments

The aggregate remuneration of the Directors during the year was as follows:

| | 2021 £ 000 | 2020 £ 000 |
|---|---|---|
| Remuneration paid to Directors in respect of qualifying services | **3,241** | 2,699 |
| Employer contributions to pension schemes (including cash paid in lieu) | **284** | 287 |
| Cash paid under long-term incentive arrangements | **60** | – |
| **Total** | **3,585** | 2,986 |

Details of the highest paid Director are set out on page 55 in the Remuneration review. The table below presents the number of Directors who:

| | 2021 Number | 2020 Number |
|---|---|---|
| Exercised share options | **–** | – |
| Received shares under long term incentive schemes | **–** | – |
| Accrued pension benefits under defined contribution pension schemes | **2** | 2 |

### 16. Taxation

The table below sets out the (charge)/credit to UK corporation tax recognised in the income statement:

| | 2021 £ million | 2020 £ million |
|---|---|---|
| **UK corporation tax** | | |
| **Current tax** | | |
| Current tax charge on profit/(loss) for the year | **(10.1)** | – |
| | | |
| **Deferred tax (note 17)** | | |
| Origination and reversal of temporary differences: | | |
| Deferred tax charge on business transfers | **(20.5)** | (20.5) |
| Change in UK corporation tax rate | **15.4** | 7.7 |
| Accelerated capital allowances | **1.2** | 0.7 |
| Adjustments in respect of prior years | **2.7** | 1.7 |
| Deferred tax (charge)/credit in relation to trading losses | **(13.4)** | 58.0 |
| Other | **(2.6)** | (2.7) |
| **Deferred tax (charge)/credit** | **(17.2)** | 44.9 |
| **Taxation (charge)/credit** | **(27.3)** | 44.9 |

# Notes to the consolidated financial statements

## Charges (continued)

### 16. Taxation (continued)

A reconciliation of the (charge)/credit that would result from applying the UK corporation tax rate to profit/(loss) before taxation to the actual taxation (charge)/credit for the year is presented below:

| | 2021 £ million | 2020 £ million |
|---|---|---|
| **Profit/(loss) before taxation** | **157.5** | (204.6) |
| | | |
| Taxation (charge)/credit at applied UK corporation tax rate of 27.0% (2020 27.0%) | **(42.5)** | 55.2 |
| | | |
| **Factors affecting charge:** | | |
| Disallowed costs | **(5.1)** | (19.7) |
| Changes to UK corporation tax rates | **15.4** | 7.7 |
| Adjustments in respect of prior years | **2.7** | 1.7 |
| Taxable profits not subject to 8% bank surcharge | **2.0** | – |
| Other | **0.2** | – |
| **Taxation (charge)/credit** | **(27.3)** | 44.9 |

The applied UK corporation tax rate of 27% includes the 8% bank surcharge on profits in excess of £25 million together with the UK corporation tax rate of 19%. Disallowed costs in 2021 primarily reflected restructuring costs. In 2020, disallowed costs included certain customer redress costs and restructuring costs.

*Changes to UK corporation tax rates*
In May 2021, the UK corporation tax rate increase from 19% to 25%, effective from April 2023, was substantively enacted. The effect of this was to increase the value of deferred tax assets by £15.4 million, with a corresponding deferred tax credit recognised in the statement of comprehensive income.

During 2020, the UK corporation tax rate was substantively enacted at 19% for 2020 and for subsequent years. Prior to this, the rate had been scheduled to reduce from 19% to 17% with effect from 1 April 2020. The effect of this was to increase the value, at 31 December 2020, of the carried forward tax losses and temporary differences that were expected to be utilised when the rate was higher than previously expected, which increased the deferred tax asset by £7.7 million.

### 17. Deferred tax assets

The movement in deferred tax assets is as follows:

| | 2021 £ million | 2020 £ million |
|---|---|---|
| **At 1 January** | **145.2** | 96.1 |
| Income statement (charge)/ credit (note 16) | **(17.2)** | 44.9 |
| Group relief | **–** | (2.7) |
| Amounts charged to equity: | | |
| Movements in fair value reserve | **0.3** | 0.2 |
| Movements in cash flow hedge reserve | **(5.0)** | 6.7 |
| **At 31 December** | **123.3** | 145.2 |

Deferred tax assets are comprised as follows:

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Deferred tax arising on carried forward trading losses | **99.6** | 102.7 |
| Deferred tax arising on business transfers | **–** | 20.5 |
| Deferred tax in respect of the transition to IFRS 9 | **18.3** | 18.2 |
| Deferred tax arising on cash flow hedge reserve | **2.4** | 7.4 |
| Revaluations of financial assets at fair value through other comprehensive income | **(4.1)** | (4.4) |
| Other temporary differences | **7.1** | 0.8 |
| **Total deferred tax assets** | **123.3** | 145.2 |

## Charges (continued)

### 17. Deferred tax assets (continued)

**Significant judgement**
The valuation and assessment of the recovery of deferred tax assets requires an estimate of the amount and timing of future taxable profits. The level of estimated future taxable profits takes into account the Board approved medium term plan and associated risk factors which estimated that the asset was recoverable within four years. A number of sensitivities were considered, including alternative forecast assumptions and execution risks associated with the Bank's strategy, which could result in a potential one year extension to the estimated recovery period. Based on this, management concluded it remains appropriate to recognise the deferred tax asset in full.

In October 2021, it was announced that the bank surcharge would be reduced from 8% to 3% with effect from 1 April 2023. This change will be reflected in the measurement of the deferred tax asset when it is substantively enacted, which is not currently expected until early 2022. The estimated impact on the deferred tax asset at 31 December 2021 had this change taken effect would have been to reduce the deferred tax asset by £12.9 million, with a corresponding deferred tax charge in the statement of comprehensive income.

# Notes to the consolidated financial statements

## Managing financial risk

**Financial instruments are fundamental to TSB's activities and, as a consequence, the risks associated with financial instruments represent a significant component of the risks faced by TSB. The primary risks affecting TSB through its use of financial instruments are credit risk, liquidity risk and market risk. A summary of TSB's use of financial instruments and information about the management of these risks is presented below.**

**Accounting policies relevant to managing financial risk**

**(j) Derivative financial instruments and hedge accounting**

All derivative financial instruments are recognised at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and using valuation techniques, including discounted cash flow as appropriate. Fair value is the exit price from the perspective of market participants who hold the asset or owe the liability at the measurement date. Derivatives are carried on the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

Changes in the fair value of derivatives are recognised immediately in the income statement, with the exception of derivatives designated in a cash flow hedge. For derivatives in cash flow hedges, the effective portion of the change in fair value is recognised in other comprehensive income until the point at which the hedged item affects profit or loss.

***Hedge accounting***

TSB elected to continue to apply the hedge accounting requirements of IAS 39 on adoption of IFRS 9. Hedge accounting allows one financial instrument, generally a derivative such as an interest rate swap, to be designated as a hedge of another financial instrument such as a loan or deposit or a portfolio of such instruments. At the inception of the hedge relationship, formal documentation is drawn up specifying the hedging strategy, the hedged item and the hedging instrument and the methodology that will be used to measure the effectiveness of the hedge relationship in offsetting changes in the fair value of the cash flows.

In its application of the hedge accounting policy, TSB follows the requirements of the UK endorsed version of IAS 39 'Financial Instruments: Recognition and Measurement' which are not available in the version issued by the IASB, specifically relating to hedging core deposits, and the relaxation of effectiveness testing, such that a layer approach can be used in a macro fair value hedge. The effectiveness of the hedging relationship is tested both at inception and throughout its life and if at any point it is concluded that it is no longer highly effective in achieving its documented objective, hedge accounting is discontinued. TSB designates certain derivatives as either hedges of the fair value of recognised assets or liabilities (fair value hedges) or hedges of highly probable future cash flows attributable to recognised assets or liabilities (cash flow hedges).

*Fair value hedges*

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement using a straight line method over the period to maturity. For micro fair value hedges, this is applied using a straight line method over the period to maturity, and for macro fair value hedges, the cumulative adjustment is amortised over the period to expiry of the relevant repricing period.

*Cash flow hedges*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income in the cash flow hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are reclassified to the income statement in the periods in which the hedged item affects profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised in the income statement when the previously hedged cash flow is ultimately recognised in the income statement.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 18. Credit risk

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

**Governance and oversight of provisioning adequacy**
All lending assets are assessed for expected credit losses (ECL) on a monthly basis. The process for assessing ECL considers information and events that have occurred in the context of current expectations of the future economic environment. Assets are reviewed to ensure that the stage allocation remains valid, that cash flow projections remain appropriate (including any potential net proceeds from the realisation of collateral) and that the projected macro-economic outcomes and associated probability weightings used to derive ECL amounts continue to remain appropriate. In the event that the future expected cash flow has changed from the previous assessment, an adjustment to the level of loss allowance is made as appropriate.

Where credit impaired assets are within a pool of similar assets and are assessed collectively, the relevance of the pool within which the asset has been placed and the assumptions regarding cash flow emanating from the pool are examined.

TSB reviews, at least annually, its provision forecast against actual loss experience to identify whether its policies have resulted in over or under provisioning across the economic cycle. Stress and scenario testing are widely used throughout TSB to assess the potential impact on impaired exposures and related provisions.

A robust governance framework has been established to monitor impairment exposures, provisions and the impact of alternative economic scenarios and stress scenarios. Findings and recommendations are reported to regular Portfolio Quality Review meetings, Executive Risk Committees, Audit Committee and the Board.

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

| | 2021 Exposure £ million | 2021 Credit Quality | 2020 Exposure £ million | 2020 Credit Quality |
|---|---|---|---|---|
| Loans and advances to customers | **37,383.8** | **Note 18(ii)** | 33,317.9 | Note 18(ii) |
| Other financial assets at amortised cost: | | | | |
| Cash, cash balances at central banks and other demand deposits: | | | | |
| Cash | **100.7** | **Not rated** | 143.6 | Not rated |
| Balances with central banks | **4,741.5** | **AA-** | 4,910.1 | AA- |
| On demand deposits | **9.0** | **At least BBB** | 2.9 | At least BBB |
| Debt securities at amortised cost[1] | **2,166.7** | **At least AA-** | 1,123.7 | At least AA- |
| Loans and advances to credit institutions | **56.1** | **A+** | 43.3 | A+ |
| Loans and advances to central banks | **143.6** | **AA-** | 120.9 | AA- |
| Government institutions | **28.6** | **AA-** | | |
| Other advances | **52.1** | **Not rated** | 220.2 | At least BBB |
| Financial assets at fair value through other comprehensive income | **1,069.0** | **AA-** | 1,496.9 | At least AA- |
| **Financial assets subject to expected credit loss requirements** | **45,751.1** | | 41,379.5 | |
| Derivative financial assets[2] | **413.8** | | 338.2 | |
| **Total on-balance sheet financial assets** | **46,164.9** | | 41,717.7 | |
| Lending commitments | **6,467.4** | **Note 18(ii)** | 6,251.5 | Note 18(ii) |
| **Maximum credit risk exposure** | **52,632.3** | | 47,969.2 | |

(1) Includes £472.8 million (2020: £482.7 million) rated AAA.
(2) The net uncollateralised balance of derivative financial instruments was £0.6million (2020: £nil) as set out in note 21, with counterparties rated A+.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 18. Credit risk

**(ii) Staging analysis**

The following table shows for loans and advance to customers the stage allocation of the loans and provisions for credit impairment losses and the resulting provision coverage ratios.

| At 31 December 2021 | Stage 1 £ million | Stage 2 £ million | Stage 3 £ million | POCI[1] £ million | Total £ million |
|---|---|---|---|---|---|
| **Loans and advances to customers** | | | | | |
| Secured (retail) | **32,182.5** | **2,121.1** | **406.8** | **123.4** | **34,833.8** |
| Unsecured | **1,622.8** | **300.9** | **65.5** | **1.4** | **1,990.6** |
| Business banking | **475.2** | **161.9** | **30.1** | **–** | **667.2** |
| **Gross customer lending balances** | **34,280.5** | **2,583.9** | **502.4** | **124.8** | **37,491.6** |
| ECL on drawn balances | **(59.0)** | **(74.4)** | **(55.4)** | **(0.8)** | **(189.6)** |
| **Net customer lending balance** | **34,221.5** | **2,509.5** | **447.0** | **124.0** | **37,302.0** |
| Valuation adjustments | | | | | **81.8** |
| **Net balance sheet carrying value** | | | | | **37,383.8** |
| | | | | | |
| **Allowance for credit impairment losses** | | | | | |
| Secured (retail) | **10.4** | **18.9** | **8.4** | **0.8** | **38.5** |
| Unsecured[2] | **42.5** | **51.9** | **46.1** | **–** | **140.5** |
| Business banking | **6.1** | **3.6** | **0.9** | **–** | **10.6** |
| **Total** | **59.0** | **74.4** | **55.4** | **0.8** | **189.6** |
| | | | | | |
| **Coverage (%)** | | | | | |
| Secured (retail) | **0.03%** | **0.89%** | **2.06%** | **0.65%** | **0.11%** |
| Unsecured | **2.62%** | **17.25%** | **70.38%** | **–%** | **7.06%** |
| Business banking | **1.28%** | **2.22%** | **2.99%** | **–%** | **1.59%** |
| **Total** | **0.17%** | **2.88%** | **11.03%** | **0.64%** | **0.51%** |

| At 31 December 2020 | Stage 1 £ million | Stage 2 £ million | Stage 3 £ million | POCI[1] £ million | Total £ million |
|---|---|---|---|---|---|
| **Loans and advances to customers** | | | | | |
| Secured (retail) | 27,773.8 | 2,540.2 | 332.6 | 143.8 | 30,790.4 |
| Unsecured | 1,395.7 | 534.8 | 62.0 | 0.2 | 1,992.7 |
| Business banking | 584.0 | 126.4 | 4.9 | – | 715.3 |
| **Gross customer lending balances** | 29,753.5 | 3,201.4 | 399.5 | 144.0 | 33,498.4 |
| ECL on drawn balances | (66.9) | (119.2) | (50.1) | (2.8) | (239.0) |
| **Net customer lending balance** | 29,686.6 | 3,082.2 | 349.4 | 141.2 | 33,259.4 |
| Valuation adjustments | | | | | 58.5 |
| **Net balance sheet carrying value** | | | | | 33,317.9 |
| | | | | | |
| **Allowance for credit impairment losses** | | | | | |
| Secured (retail) | 10.6 | 19.8 | 10.2 | 2.8 | 43.4 |
| Unsecured[2] | 51.1 | 97.8 | 38.7 | – | 187.6 |
| Business banking | 5.2 | 1.6 | 1.2 | – | 8.0 |
| **Total** | 66.9 | 119.2 | 50.1 | 2.8 | 239.0 |
| | | | | | |
| **Coverage (%)** | | | | | |
| Secured (retail) | 0.04% | 0.78% | 3.07% | 1.95% | 0.14% |
| Unsecured | 3.66% | 18.29% | 62.42% | –% | 9.41% |
| Business banking | 0.89% | 1.27% | 24.49% | –% | 1.12% |
| **Total** | 0.22% | 3.72% | 12.54% | 1.94% | 0.71% |

(1) Purchased or originated as credit impaired.
(2) Excludes expected credit impairment provisions for off balance sheet exposures of £16.7 million (2020: £19.2 million). These comprise of stage 1 £8.9 million (2020: £13.1 million), stage 2 £4.8 million (2020: £5.6 million), and stage 3 £3.0 million (2020: £0.4 million).

For all other classes of financial assets (as listed in note 18(i) on page 88), expected credit losses have been assessed as immaterial.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 18. Credit risk

**(iii) Reconciliation of movements in gross customer balances and allowances for credit impairment losses**

The tables below summarise the movements between stages for loans and advances to customers. In addition, the movement in expected credit loss provisions in respect of off balance sheet exposures is shown in note 29.

| | Stage 1 | | Stage 2 | | Stage 3 | | POCI | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| TSB | Gross £ million | ECL £ million | Gross £ million | ECL £ million | Gross £ million | ECL £ million | Gross £ million | ECL £ million | Gross £ million | ECL £ million |
| At 1 January 2021 | 29,753.5 | (66.9) | 3,201.4 | (119.2) | 399.5 | (50.1) | 144.0 | (2.8) | 33,498.4 | (239.0) |
| Changes reflected in impairment losses: | 4,559.7 | 12.7 | (358.4) | 2.9 | (132.8) | (8.4) | (19.2) | 2.0 | 4,049.3 | 9.2 |
| Increases due to originations | 9,991.5 | (46.0) | 67.1 | (2.0) | 14.1 | (0.2) | 4.2 | – | 10,076.9 | (48.2) |
| Decreases due to repayments | (5,431.8) | 7.4 | (425.5) | 7.5 | (146.9) | 6.6 | (23.4) | – | (6,027.6) | 21.5 |
| Changes in credit risk(1) | – | 51.3 | – | (2.6) | – | (14.8) | – | 2.0 | – | 35.9 |
| Amounts written off | (0.6) | – | (1.3) | 0.9 | (54.2) | 39.3 | – | – | (56.1) | 40.2 |
| Transfers between stages(2) (3) | (32.1) | (4.8) | (257.8) | 41.0 | 289.9 | (36.2) | – | – | – | – |
| To stage 1 | 2,545.4 | (43.5) | (2,491.3) | 43.1 | (54.1) | 0.4 | – | – | – | – |
| To stage 2 | (2,525.6) | 36.8 | 2,589.0 | (39.6) | (63.4) | 2.8 | – | – | – | – |
| To stage 3 | (51.9) | 1.9 | (355.5) | 37.5 | 407.4 | (39.4) | – | – | – | – |
| **At 31 December 2021** | 34,280.5 | (59.0) | 2,583.9 | (74.4) | 502.4 | (55.4) | 124.8 | (0.8) | 37,491.6 | (189.6) |
| **Secured (retail)** | | | | | | | | | | |
| At 1 January 2021 | 27,773.8 | (10.6) | 2,540.2 | (19.8) | 332.6 | (10.2) | 143.8 | (2.8) | 30,790.4 | (43.4) |
| Changes reflected in impairment losses: | 4,388.8 | 0.6 | (222.1) | (0.9) | (102.6) | 3.9 | (20.4) | 2.0 | 4,043.7 | 5.6 |
| Increases due to originations | 9,260.4 | (19.2) | 5.1 | – | 5.1 | (0.1) | 2.7 | – | 9,273.3 | (19.3) |
| Decreases due to repayments | (4,871.6) | 1.1 | (227.2) | 1.7 | (107.7) | 3.7 | (23.1) | – | (5,229.6) | 6.5 |
| Changes in credit risk | – | 18.7 | – | (2.6) | – | 0.3 | – | 2.0 | – | 18.4 |
| Amounts written off | – | – | – | – | (0.3) | (0.7) | – | – | (0.3) | (0.7) |
| Transfers between stages | 19.9 | (0.4) | (197.0) | 1.8 | 177.1 | (1.4) | – | – | – | – |
| To stage 1 | 1,591.9 | (3.7) | (1,543.3) | 3.6 | (48.6) | 0.1 | – | – | – | – |
| To stage 2 | (1,540.9) | 2.6 | 1,595.9 | (3.4) | (55.0) | 0.8 | – | – | – | – |
| To stage 3 | (31.1) | 0.7 | (249.6) | 1.6 | 280.7 | (2.3) | – | – | – | – |
| **At 31 December 2021** | 32,182.5 | (10.4) | 2,121.1 | (18.9) | 406.8 | (8.4) | 123.4 | (0.8) | 34,833.8 | (38.5) |
| **Unsecured** | | | | | | | | | | |
| At 1 January 2021 | 1,395.7 | (51.1) | 534.8 | (97.8) | 62.0 | (38.7) | 0.2 | – | 1,992.7 | (187.6) |
| Changes reflected in impairment losses: | 197.9 | 13.2 | (126.0) | 6.2 | (20.2) | (12.8) | 1.2 | – | 52.9 | 6.6 |
| Increases due to originations | 592.2 | (25.7) | 29.2 | (1.6) | 7.8 | (0.1) | 1.5 | – | 630.7 | (27.4) |
| Decreases due to repayments | (394.3) | 6.1 | (155.2) | 5.7 | (28.0) | 2.9 | (0.3) | – | (577.8) | 14.7 |
| Changes in credit risk | – | 32.8 | – | 2.1 | – | (15.6) | – | – | – | 19.3 |
| Amounts written off | (0.6) | – | (1.3) | 0.7 | (53.1) | 39.8 | – | – | (55.0) | 40.5 |
| Transfers between stages: | 29.8 | (4.6) | (106.6) | 39.0 | 76.8 | (34.4) | – | – | – | – |
| To stage 1 | 728.8 | (37.7) | (724.2) | 37.4 | (4.6) | 0.3 | – | – | – | – |
| To stage 2 | (679.1) | 31.9 | 685.9 | (33.8) | (6.8) | 1.9 | – | – | – | – |
| To stage 3 | (19.9) | 1.2 | (68.3) | 35.4 | 88.2 | (36.6) | – | – | – | – |
| **At 31 December 2021** | 1,622.8 | (42.5) | 300.9 | (51.9) | 65.5 | (46.1) | 1.4 | – | 1,990.6 | (140.5) |
| **Business banking** | | | | | | | | | | |
| At 1 January 2021 | 584.0 | (5.2) | 126.4 | (1.6) | 4.9 | (1.2) | – | – | 715.3 | (8.0) |
| Changes reflected in impairment losses: | (27.0) | (1.1) | (10.3) | (2.4) | (10.0) | 0.5 | – | – | (47.3) | (3.0) |
| Increases due to originations | 138.9 | (1.1) | 32.8 | (0.4) | 1.2 | – | – | – | 172.9 | (1.5) |
| Decreases due to repayments | (165.9) | 0.2 | (43.1) | 0.1 | (11.2) | – | – | – | (220.2) | 0.3 |
| Changes in credit risk | – | (0.2) | – | (2.1) | – | 0.5 | – | – | – | (1.8) |
| Amounts written off | – | – | – | 0.2 | (0.8) | 0.2 | – | – | (0.8) | 0.4 |
| Transfers between stages: | (81.8) | 0.2 | 45.8 | 0.2 | 36.0 | (0.4) | – | – | – | – |
| To stage 1 | 224.7 | (2.1) | (223.8) | 2.1 | (0.9) | – | – | – | – | – |
| To stage 2 | (305.6) | 2.3 | 307.2 | (2.4) | (1.6) | 0.1 | – | – | – | – |
| To stage 3 | (0.9) | – | (37.6) | 0.5 | 38.5 | (0.5) | – | – | – | – |
| **At 31 December 2021** | 475.2 | (6.1) | 161.9 | (3.6) | 30.1 | (0.9) | – | – | 667.2 | (10.6) |

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 18. Credit risk

### (iii) Reconciliation of movements in gross customer balances and allowances for credit impairment losses

| | Stage 1 | | Stage 2 | | Stage 3 | | POCI | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| **TSB** | **Gross £ million** | **ECL £ million** | **Gross £ million** | **ECL £ million** | **Gross £ million** | **ECL £ million** | **Gross £ million** | **ECL £ million** | **Gross £ million** | **ECL £ million** |
| At 1 January 2020 | 28,181.7 | (52.3) | 2,449.9 | (60.8) | 382.5 | (47.7) | 161.3 | (2.2) | 31,175.4 | (163.0) |
| Transfers to credit impairment provisions | – | 8.6 | – | 6.5 | – | 0.2 | – | – | – | 15.3 |
| Changes reflected in impairment losses: | | | | | | | | | | |
| Increases due to originations | 7,594.3 | (48.1) | 80.0 | (0.3) | 15.5 | – | 6.3 | – | 7,696.1 | (48.4) |
| Decreases due to repayments | (4,725.5) | 16.9 | (480.2) | 4.0 | (76.8) | 2.5 | (23.6) | – | (5,306.1) | 23.4 |
| Changes in credit risk[1] | – | 30.1 | – | (116.6) | – | (22.6) | – | (0.6) | - | (109.7) |
| Amounts written off | – | – | – | – | (67.0) | 43.4 | – | – | (67.0) | 43.4 |
| Transfers between stages[2] [3] | (1,297.0) | (22.1) | 1,151.7 | 48.0 | 145.3 | (25.9) | – | – | – | – |
| To stage 1 | 3,469.8 | (107.9) | (3,454.0) | 104.9 | (15.8) | 3.0 | – | – | – | – |
| To stage 2 | (4,746.3) | 85.2 | 4,824.3 | (90.7) | (78.0) | 5.5 | – | – | – | – |
| To stage 3 | (20.5) | 0.6 | (218.6) | 33.8 | 239.1 | (34.4) | – | – | – | – |
| At 31 December 2020 | 29,753.5 | (66.9) | 3,201.4 | (119.2) | 399.5 | (50.1) | 144.0 | (2.8) | 33,498.4 | (239.0) |
| **Secured (retail)** | | | | | | | | | | |
| At 1 January 2020 | 26,747.4 | (16.3) | 1,976.9 | (7.5) | 303.7 | (8.8) | 161.2 | (2.1) | 29,189.2 | (34.7) |
| Transfers to credit impairment provisions | – | – | – | – | – | 0.1 | – | – | – | 0.1 |
| Changes reflected in impairment losses: | | | | | | | | | | |
| Increases due to originations | 6,164.0 | (32.4) | 13.1 | (0.3) | 6.0 | – | 4.5 | – | 6,187.6 | (32.7) |
| Decreases due to repayments | (4,193.9) | 15.9 | (317.1) | 1.3 | (53.0) | 2.3 | (21.9) | – | (4,585.9) | 19.5 |
| Changes in credit risk | – | 10.3 | – | (5.3) | – | 0.1 | – | (0.7) | – | 4.4 |
| Amounts written off | – | – | – | – | (0.5) | – | – | – | (0.5) | – |
| Transfers between stages | (943.7) | 11.9 | 867.3 | (8.0) | 76.4 | (3.9) | – | – | – | – |
| To stage 1 | 2,667.8 | (7.8) | (2,656.9) | 7.5 | (10.9) | 0.3 | – | – | – | – |
| To stage 2 | (3,607.4) | 19.6 | 3,679.7 | (21.3) | (72.3) | 1.7 | – | – | – | – |
| To stage 3 | (4.1) | 0.1 | (155.5) | 5.8 | 159.6 | (5.9) | – | – | – | – |
| At 31 December 2020 | 27,773.8 | (10.6) | 2,540.2 | (19.8) | 332.6 | (10.2) | 143.8 | (2.8) | 30,790.4 | (43.4) |
| **Unsecured** | | | | | | | | | | |
| At 1 January 2020 | 1,316.2 | (34.3) | 463.4 | (52.6) | 75.3 | (38.1) | 0.1 | (0.1) | 1,855.0 | (125.1) |
| Transfers to credit impairment provisions | – | 8.3 | – | 6.4 | – | 0.1 | – | – | – | 14.8 |
| Changes reflected in impairment losses: | | | | | | | | | | |
| Increases due to originations | 708.0 | (13.1) | 10.8 | – | 7.0 | – | 1.8 | – | 727.6 | (13.1) |
| Decreases due to repayments | (357.3) | 1.0 | (143.8) | 2.6 | (20.9) | 0.1 | (1.7) | – | (523.7) | 3.7 |
| Changes in credit risk | – | 8.2 | – | (96.9) | - | (22.7) | – | 0.1 | – | (111.3) |
| Amounts written off | – | – | – | – | (66.2) | 43.4 | – | – | (66.2) | 43.4 |
| Transfers between stages: | (271.2) | (21.2) | 204.4 | 42.7 | 66.8 | (21.5) | – | – | – | – |
| To stage 1 | 676.5 | (81.8) | (672.1) | 79.5 | (4.4) | 2.3 | – | – | – | – |
| To stage 2 | (931.5) | 60.1 | 936.6 | (63.7) | (5.1) | 3.6 | – | – | – | – |
| To stage 3 | (16.2) | 0.5 | (60.1) | 26.9 | 76.3 | (27.4) | – | – | – | – |
| At 31 December 2020 | 1,395.7 | (51.1) | 534.8 | (97.8) | 62.0 | (38.7) | 0.2 | – | 1,992.7 | (187.6) |
| **Business banking** | | | | | | | | | | |
| At 31 December 2020 | 118.1 | (1.7) | 9.6 | (0.7) | 3.5 | (0.8) | – | – | 131.2 | (3.2) |
| Transfers to credit impairment provisions | – | 0.3 | – | 0.1 | – | | – | – | – | 0.4 |
| Changes reflected in impairment losses: | | | | | | | | | | |
| Increases due to originations | 722.3 | (2.6) | 56.1 | – | 2.5 | - | – | – | 780.9 | (2.6) |
| Decreases due to repayments | (174.3) | – | (19.3) | 0.1 | (2.9) | 0.1 | – | – | (196.5) | 0.2 |
| Changes in credit risk | – | 11.6 | - | (14.4) | – | – | – | – | – | (2.8) |
| Amounts written off | – | – | – | – | (0.3) | – | – | – | (0.3) | – |
| Transfers between stages: | (82.1) | (12.8) | 80.0 | 13.3 | 2.1 | (0.5) | – | – | – | – |
| To stage 1 | 125.5 | (18.3) | (125.0) | 17.9 | (0.5) | 0.4 | – | – | – | – |
| To stage 2 | (207.4) | 5.5 | 208.0 | (5.7) | (0.6) | 0.2 | – | – | – | – |
| To stage 3 | (0.2) | – | (3.0) | 1.1 | 3.2 | (1.1) | – | – | – | – |
| **At 31 December 2020** | 584.0 | (5.2) | 126.4 | (1.6) | 4.9 | (1.2) | – | – | 715.3 | (8.0) |

(1) Includes changes to the allowance for credit impairment losses arising from stage transfers and other changes to risk parameters.
(2) Transfers between stages are an aggregation of monthly movements over the year and are based on balances and ECL at the start of each month.
(3) The net remeasurement of ECL on stage transfer is reported within the stage that the assets are transferred into. This represents the period to date ECL movement on net assets transferred into a particular stage. This is not a subtotal of the 'transfers from' and 'transfers to' rows that precede this row.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 18. Credit risk

### (iii) Reconciliation of movements in gross customer balances and allowances for credit impairment losses

*Performance overview*

Gross loans balances increased by £3,993.2 million to £37,491.6 million, driven by Secured (retail) lending growth. This primarily reflected a strong trading performance in a buoyant market during 2021, supported by high customer demand for house moves and government initiatives such as the Stamp Duty Land Tax Waiver that ended in September 2021. This was partly offset by the expected reduction in the closed Whistletree portfolio.

Stage 1 gross customer lending balances increased by £4,527.0 million to £34,280.5 million largely reflecting the net origination described above.

Stage 2 gross customer lending balances decreased by £617.5 million to £2,583.9 million. This reflected an improving economic outlook and, in addition, the inclusion in the stage 3 unlikely to pay criterion of interest only mortgages more than 90 days past their maturity date and where the customer has not repaid the balance in full. These past term interest only (PTIO) mortgages were previously considered to be stage 2. This change resulted in a £164.3 million decrease in stage 2 balances. The reduction in stage 2 balances also reflected ongoing loan repayments by customers.

Stage 3 gross customer lending balances increased by £102.9 million to £502.4 million, primarily driven by the inclusion of PTIO mortgages, as discussed above, partially offset by transfers back to stage 2 reflecting the improving economic environment and ongoing customer loan repayments.

Gross loans written off during 2021 of £56.1 million (2020: £67.0 million) continue to be subject to the right to undertake enforcement activities, despite there being no realistic prospect of recovery.

*Reconciliation to amounts recognised in the income statement*

| | 2021<br>£ million | 2020<br>£ million |
|---|---|---|
| Changes in credit risk | **(11.7)** | 136.0 |
| Gross amounts written off | **56.1** | 67.0 |
| Less: Release of allowance associated with gross amounts written off | **(40.2)** | (43.4) |
| **Income statement charge reported in ECL movement table on page 90** | **4.2** | 159.6 |
| Recoveries of amounts previously written off | **(14.1)** | (12.1) |
| Other amounts charged to the income statement | **10.0** | 16.5 |
| **Total credit impairment charge** | **0.1** | 164.0 |

Impairment losses recognised in the income statement totalled £0.1 million (2020: £164.0 million). These comprise of changes in the impairment allowance reflected in the lines under the heading 'changes reflected in impairment losses' in the table on page 90 together with the net amounts written off, again as reflected in the table on page 90. In addition, impairment losses include the subsequent recovery of amounts previously written off and other amounts charged directly to the income statement.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 18. Credit risk

**(iv) Stage 2 balances**

There can be a number of reasons that require a financial asset to be subject to a stage 2 lifetime ECL calculation other than reaching the 30 days past due backstop. The following table highlights the relevant trigger point leading to a financial asset being classified in stage 2:

| At 31 December 2021 | PD Deterioration £ million | Performing Forborne £ million | >30DPD £ million | Total £ million |
|---|---|---|---|---|
| **Gross customer lending balances** | | | | |
| Secured (retail) | **1,980.0** | **53.9** | **87.2** | **2,121.1** |
| Unsecured | **286.6** | **2.2** | **12.1** | **300.9** |
| Business banking | **133.9** | **2.9** | **25.1** | **161.9** |
| **Total** | **2,400.5** | **59.0** | **124.4** | **2,583.9** |
| **Allowance for credit impairment losses** | | | | |
| Secured (retail) | **18.0** | **0.3** | **0.6** | **18.9** |
| Unsecured | **45.7** | **0.3** | **5.9** | **51.9** |
| Business banking | **2.6** | **–** | **1.0** | **3.6** |
| **Total** | **66.3** | **0.6** | **7.5** | **74.4** |

| At 31 December 2020 | PD Deterioration £ million | Performing Forborne £ million | >30DPD £ million | Total £ million |
|---|---|---|---|---|
| **Gross customer lending balances** | | | | |
| Secured (retail) | 2,342.3 | 60.8 | 137.1 | 2,540.2 |
| Unsecured | 514.3 | 2.1 | 18.4 | 534.8 |
| Business banking | 122.5 | 0.1 | 3.8 | 126.4 |
| **Total** | 2,979.1 | 63.0 | 159.3 | 3,201.4 |
| **Allowance for credit impairment losses** | | | | |
| Secured (retail) | 18.0 | 0.3 | 1.5 | 19.8 |
| Unsecured | 87.1 | 0.3 | 10.4 | 97.8 |
| Business banking | 1.3 | – | 0.3 | 1.6 |
| **Total** | 106.4 | 0.6 | 12.2 | 119.2 |

**(v) Stage 3 balances**

| Stage 3 | Gross loans £ million | 2021 ECL £ million | Gross loans £ million | 2020 ECL £ million |
|---|---|---|---|---|
| Credit impaired - not in a cure period | **263.9** | **(31.5)** | 304.9 | (37.0) |
| Credit impaired - in the cure period that precedes transfer to stage 2 | **238.5** | **(23.9)** | 94.6 | (13.1) |
| **Total stage 3** | **502.4** | **(55.4)** | 399.5 | (50.1) |

Balances that are credit impaired and not in a cure period comprise of loans and advances to customers that are more than 90 days past due, or considered by management as unlikely to pay their obligations, as described under the heading 'definition of default for IFRS 9' on page 71. Balances that were credit impaired but operating within the cure period required by TSB policy prior to a transfer to stage 2 comprise of customers who have cured but who were 90 days past due, or considered unlikely to pay in the previous six months.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 18. Credit risk

**(vi) Credit quality of loans and advances to customers and lending commitments**

In assessing the credit quality of loans and advances to customers and lending commitments, TSB uses an internal rating scale which assigns a grade based on a customer's 12 month expected probability of default (PD). The PDs used to assign a risk grade, as shown in the table below, are point in time PDs. This is different to the IFRS 9 PDs used to assess IFRS 9 staging and expected credit loss measurement which are adjusted to reflect the effect of forward looking economic scenarios.

| | PD range Lower | PD range Upper | Internal grading |
|---|---|---|---|
| Excellent quality | 0% | 1.200% | 1-4 |
| Good quality | 1.201% | 4.500% | 5-6 |
| Satisfactory quality | 4.501% | 14.000% | 7-9 |
| Lower quality | 14.001% | 20.000% | 10 |
| Below standard (including in default) | 20.001% | 100% | 11-13 |

The table below sets out the credit quality, by stage, of gross loan and advances to customers.

| | Gross loans | | | | | Allowance for credit impairment losses | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 2021 | Stage 1 £ million | Stage 2 £ million | Stage 3 £ million | POCI £ million | Total £ million | Stage 1 £ million | Stage 2 £ million | Stage 3 £ million | POCI £ million | Total £ million |
| **Secured (retail)** | | | | | | | | | | |
| Excellent quality | **31,570.1** | **12.2** | **–** | **2.0** | **31,584.3** | **9.2** | **14.5** | **–** | **–** | **23.7** |
| Good quality | **589.5** | **153.5** | **–** | **46.0** | **789.0** | **1.1** | **0.4** | **–** | **–** | **1.5** |
| Satisfactory quality | **18.2** | **1,286.9** | **–** | **26.1** | **1,331.2** | **0.1** | **2.0** | **–** | **–** | **2.1** |
| Lower quality | **2.1** | **172.8** | **–** | **0.5** | **175.4** | **–** | **0.2** | **–** | **–** | **0.2** |
| Below standard | **2.6** | **495.7** | **406.8** | **48.8** | **953.9** | **–** | **1.8** | **8.3** | **0.8** | **10.9** |
| | **32,182.5** | **2,121.1** | **406.8** | **123.4** | **34,833.8** | **10.4** | **18.9** | **8.3** | **0.8** | **38.4** |
| **Unsecured** | | | | | | | | | | |
| Excellent quality | **672.9** | **12.2** | **2.6** | **–** | **687.7** | **9.7** | **1.0** | **1.6** | **–** | **12.3** |
| Good quality | **833.8** | **139.9** | **7.5** | **–** | **981.2** | **23.3** | **15.0** | **4.6** | **–** | **42.9** |
| Satisfactory quality | **106.5** | **109.1** | **8.0** | **0.3** | **223.9** | **8.0** | **20.2** | **5.0** | **–** | **33.2** |
| Lower quality | **4.4** | **18.2** | **3.8** | **–** | **26.4** | **0.8** | **5.8** | **2.5** | **–** | **9.1** |
| Below standard | **5.2** | **21.5** | **43.6** | **1.1** | **71.4** | **0.8** | **9.9** | **32.3** | **–** | **43.0** |
| | **1,622.8** | **300.9** | **65.5** | **1.4** | **1,990.6** | **42.6** | **51.9** | **46.0** | **–** | **140.5** |
| **Business banking** | | | | | | | | | | |
| Excellent quality | **200.0** | **–** | **–** | **–** | **200.0** | **1.7** | **–** | **–** | **–** | **1.7** |
| Good quality | **250.2** | **0.8** | **–** | **–** | **251.0** | **3.8** | **–** | **–** | **–** | **3.8** |
| Satisfactory quality | **24.9** | **77.1** | **–** | **–** | **102.0** | **0.5** | **1.8** | **–** | **–** | **2.3** |
| Lower quality | **–** | **4.0** | **–** | **–** | **4.0** | **–** | **0.1** | **–** | **–** | **0.1** |
| Below standard | **0.1** | **80.0** | **30.1** | **–** | **110.2** | **–** | **1.7** | **0.9** | **–** | **2.6** |
| | **475.2** | **161.9** | **30.1** | **–** | **667.2** | **6.0** | **3.6** | **0.9** | **–** | **10.5** |
| **Commitments** | | | | | | | | | | |
| Excellent quality | **5,648.5** | **39.8** | **8.3** | **0.2** | **5,696.8** | **5.9** | **1.0** | **1.1** | **–** | **8.0** |
| Good quality | **413.3** | **211.6** | **3.8** | **12.0** | **640.7** | **1.5** | **2.1** | **0.6** | **–** | **4.2** |
| Satisfactory quality | **59.8** | **29.1** | **2.3** | **0.3** | **91.5** | **1.5** | **1.1** | **0.4** | **–** | **3.0** |
| Lower quality | **0.7** | **9.1** | **0.8** | **8.0** | **18.6** | **–** | **0.4** | **0.1** | **–** | **0.5** |
| Below standard | **0.8** | **3.3** | **15.5** | **0.4** | **20.0** | **–** | **0.2** | **0.8** | **–** | **1.0** |
| **Total** | **6,123.1** | **292.9** | **30.7** | **20.9** | **6,467.6** | **8.9** | **4.8** | **3.0** | **–** | **16.7** |

## Managing financial risk (continued)

### 18. Credit risk (continued)

**(vi) Credit quality of loans and advances to customers and lending commitments (continued)**

| 2020 | Gross loans | | | | | Allowance for credit impairment losses | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stage 1 £ million | Stage 2 £ million | Stage 3 £ million | POCI £ million | Total £ million | Stage 1 £ million | Stage 2 £ million | Stage 3 £ million | POCI £ million | Total £ million |
| **Secured (retail)** | | | | | | | | | | |
| Excellent quality | 27,000.4 | 119.6 | – | 1.9 | 27,121.9 | 9.8 | 0.8 | – | – | 10.6 |
| Good quality | 451.9 | 382.5 | – | 69.5 | 903.9 | 0.7 | 3.4 | – | – | 4.1 |
| Satisfactory quality | 317.7 | 1,466.3 | – | 5.5 | 1,789.5 | 0.1 | 6.6 | – | – | 6.7 |
| Lower quality | 2.7 | 65.1 | – | 0.6 | 68.4 | – | 0.4 | – | – | 0.4 |
| Below standard | 1.1 | 506.7 | 332.6 | 66.3 | 906.7 | – | 8.6 | 10.2 | 2.8 | 21.6 |
| | 27,773.8 | 2,540.2 | 332.6 | 143.8 | 30,790.4 | 10.6 | 19.8 | 10.2 | 2.8 | 43.4 |
| **Unsecured** | | | | | | | | | | |
| Excellent quality | 1,138.7 | 165.2 | 3.4 | – | 1,307.3 | 43.1 | 32.5 | 3.1 | – | 78.7 |
| Good quality | 219.2 | 257.9 | 4.2 | – | 481.3 | 6.8 | 46.5 | 2.3 | – | 55.6 |
| Satisfactory quality | 33.6 | 80.2 | 4.5 | – | 118.3 | 1.1 | 14.1 | 2.6 | – | 17.8 |
| Lower quality | 3.1 | 11.9 | 1.6 | – | 16.6 | 0.1 | 1.7 | 0.4 | – | 2.2 |
| Below standard | 1.1 | 19.6 | 48.3 | 0.2 | 69.2 | – | 3.0 | 30.3 | – | 33.3 |
| | 1,395.7 | 534.8 | 62.0 | 0.2 | 1,992.7 | 51.1 | 97.8 | 38.7 | – | 187.6 |
| **Business banking** | | | | | | | | | | |
| Excellent quality | 198.1 | – | – | – | 198.1 | 1.7 | – | – | – | 1.7 |
| Good quality | 123.3 | 0.9 | 0.1 | – | 124.3 | 1.6 | – | – | – | 1.6 |
| Satisfactory quality | 232.5 | 15.1 | – | – | 247.6 | 1.8 | 0.4 | – | – | 2.2 |
| Lower quality | 29.9 | 29.9 | – | – | 59.8 | 0.1 | 0.2 | – | – | 0.3 |
| Below standard | 0.2 | 80.5 | 4.8 | – | 85.5 | – | 1.0 | 1.2 | – | 2.2 |
| | 584.0 | 126.4 | 4.9 | – | 715.3 | 5.2 | 1.6 | 1.2 | – | 8.0 |
| **Commitments** | | | | | | | | | | |
| Excellent quality | 5,512.5 | 142.0 | 5.0 | 0.3 | 5,659.8 | 12.5 | 2.1 | 1.0 | – | 15.6 |
| Good quality | 294.6 | 173.4 | 1.9 | 18.0 | 487.9 | 1.1 | 1.6 | 0.1 | – | 2.8 |
| Satisfactory quality | 47.6 | 24.8 | 1.2 | 0.6 | 74.2 | – | 0.6 | – | – | 0.6 |
| Lower quality | 1.3 | 3.5 | 0.2 | – | 5.0 | – | 0.1 | – | – | 0.1 |
| Below standard | – | 2.2 | 21.0 | 1.4 | 24.6 | – | - | 0.1 | – | 0.1 |
| **Total** | 5,856.0 | 345.9 | 29.3 | 20.3 | 6,251.5 | 13.6 | 4.4 | 1.2 | – | 19.2 |

**(vii) Collateral held as security for financial assets**

*Financial assets subject to expected credit loss requirements*
TSB holds collateral against loans and advances to customers in the form of mortgages over residential property and second charges over business assets, including commercial and residential property.

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

| LTV of Secured (retail) | 2021 | | | | | 2020 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Stage 1 £ million | Stage 2 £ million | Stage 3 £ million | POCI £ million | Total £ million | Stage 1 £ million | Stage 2 £ million | Stage 3 £ million | POCI £ million | Total £ million |
| Less than 70% | **22,876.0** | **1,909.7** | **347.5** | **106.2** | **25,239.4** | 19,364.2 | 2,270.2 | 250.2 | 112.1 | 21,996.7 |
| 70% to 80% | **6,561.5** | **164.0** | **36.7** | **11.8** | **6,774.0** | 5,539.9 | 189.4 | 40.9 | 20.7 | 5,790.9 |
| 80% to 90% | **2,535.4** | **43.8** | **13.2** | **4.1** | **2,596.5** | 2,778.5 | 70.2 | 20.6 | 6.7 | 2,876.0 |
| 90% to 100% | **199.9** | **2.8** | **3.6** | **0.3** | **206.6** | 79.1 | 5.5 | 14.1 | 3.7 | 102.4 |
| Greater than 100% | **9.7** | **0.8** | **5.8** | **1.0** | **17.3** | 12.1 | 4.9 | 6.8 | 0.6 | 24.4 |
| **Secured (retail)** | **32,182.5** | **2,121.1** | **406.8** | **123.4** | **34,833.8** | 27,773.8 | 2,540.2 | 332.6 | 143.8 | 30,790.4 |

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 18. Credit risk (continued)

**(vii) Collateral held as security for financial assets (continued)**
TSB does not take physical possession of properties or other assets held as collateral and uses external agents to realise the value as soon as practicable to settle indebtedness. Any surplus funds are returned to the borrower or are otherwise dealt with in accordance with appropriate insolvency regulations. No collateral is held in respect of retail credit cards, overdrafts, or unsecured personal loans.

For business banking lending, collateral primarily consists of second charges over commercial and residential property. Where collateral is held, lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on any collateral provided. Collateral values are assessed at the time of loan origination and reassessed if there is observable evidence of distress of the borrower. In respect of the £518.8 million (2020: £576.8 million) of Bounce Back Loan Scheme loans, in addition to collateral provided by the customer, TSB benefits from a 100% guarantee from the British Business Bank (amounts recoverable under this guarantee are shown in note 9 on page 79).

*Financial assets at fair value through profit or loss (not subject to expected credit loss requirements)*
Derivative financial assets of £413.8 million (2020: £338.2 million) are largely cash collateralised interest rate swaps transacted through central clearing houses. The effect of the collateralisation is shown in note 21 on page 104 under the heading Offsetting financial assets and liabilities.

**(viii) Forbearance and loan modifications**
TSB operates a number of schemes to assist borrowers who are experiencing financial difficulties. Forbearance solutions may offer relief in the form of reductions to contractual payments including freezes to interest payments, and for customers who have longer term financial difficulties, term extensions and capitalisation of arrears. TSB applies the European Banking Authority definition of forbearance and at 31 December 2021, forborne loans were £318.8 million (2020: £301.3 million), of which £222.6 million (2020: £170.6 million) were credit impaired. At 31 December 2021, the allowance for loan losses held in respect of forborne loans was £42.0 million (2020: £26.3 million).

During 2021 gross balances of £35.3 million (2020: £14.7 million) in respect of unsecured loans were subject to modification of the original terms through the temporary freezing of customer interest obligations. At the time, the loans were categorised as either stage 2 or 3 and the allowance for expected credit losses was measured at lifetime expected credit loss. These resulted in modification losses of £1.7 million (2020: £0.8 million).

**(ix) Response to COVID-19 in the prior year**
In response to the COVID-19 pandemic, during 2020, TSB introduced, for an interim temporary period, repayment holidays to enable customers to take a temporary break from making loan repayments where they were experiencing, or were reasonably expected to experience, payment difficulties caused by COVID-19. During the period of the repayment holiday, no further arrears were reported on customers' records although interest on the deferred payments continued to accrue. Customers were able to apply for these COVID-19 arrangements until March 2021.

As at 31 December 2021, no loans and advances to customers were being operated under these earlier arrangements.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 19. Liquidity risk

**Definition and exposure**

Liquidity risk is the risk that TSB is unable to meet its liabilities as they fall due, or is unable to maintain regulator, investor, customer or stakeholder confidence that this will be achieved. Liquidity risk is managed, monitored and measured from both an internal and regulatory perspective.

**Sources of funding**

TSB's funding position is underpinned by its significant customer deposit base. The deposit base is made up of customer current and savings accounts which, although mostly repayable on demand, have historically provided a stable source of funding. Further information regarding sources of funding is available on pages 66 to 69.

**Risk appetite**

The funding and liquidity risk appetite for TSB is set and approved annually by the Board. Risk is reported against this appetite through various metrics to enable TSB to manage the funding and liquidity position. The risk appetite is established under a liquidity risk management framework designed with the aim that TSB has sufficient financial resources of appropriate quality.

**Measurement and monitoring**

A series of measures are used across TSB to monitor both short term and long term liquidity risk. Liquidity risk is measured on a daily basis and reported internally. Daily liquidity reporting is supplemented by early warning indicators and a Liquidity Contingency Plan. Monthly reporting procedures are in place to update and inform senior management. All liquidity policies and procedures are subject to periodic independent internal oversight.

The table below presents the contractual residual maturities of the financial liabilities and assets on the balance sheet:

| At 31 December 2021 | Up to 1 month £ million | 1-3 months £ million | 3-12 months £ million | 1-5 years £ million | Over 5 years £ million | Total Carrying Value £ million |
|---|---|---|---|---|---|---|
| Financial liabilities measured at amortised cost: | | | | | | |
| Customer deposits | 34,247.7 | 150.6 | 791.3 | 762.3 | – | 35,951.9 |
| Borrowings from central banks | 1.6 | – | – | 5,500.0 | – | 5,501.6 |
| Debt securities in issue | – | 1.1 | 499.3 | 1,199.0 | 499.7 | 2,199.1 |
| Subordinated liabilities | – | 0.1 | – | 291.7 | – | 291.8 |
| Lease liabilities | 0.3 | – | 0.2 | 31.3 | 131.7 | 163.5 |
| Other financial liabilities | 194.3 | – | – | – | – | 194.3 |
| Derivative liabilities at fair value through profit or loss | 0.6 | 4.2 | 8.7 | 119.5 | 23.5 | 156.5 |
| Hedging derivative liabilities | 0.4 | 1.1 | 8.5 | 51.4 | 75.4 | 136.8 |
| **Total financial liabilities** | **34,444.9** | **157.1** | **1,308.0** | **7,955.2** | **730.3** | **44,595.5** |
| | | | | | | |
| Financial assets at amortised cost: | | | | | | |
| Cash, cash balances at central banks and demand deposits | 4,851.2 | – | – | – | – | 4,851.2 |
| Debt securities | 3.1 | 4.4 | 69.1 | 302.1 | 1,788.0 | 2,166.7 |
| Loans and advances to customers | 881.7 | 343.8 | 1,508.1 | 7,046.3 | 27,603.9 | 37,383.8 |
| Loans to credit institutions | 56.1 | – | – | – | – | 56.1 |
| Loans to central banks | 143.6 | – | – | – | – | 143.6 |
| Other advances | 63.5 | 17.2 | – | – | – | 80.7 |
| Financial assets at fair value through other comprehensive income | 0.3 | 2.1 | 0.9 | 1.2 | 1,064.5 | 1,069.0 |
| Derivative assets at fair value through profit or loss | 1.4 | 2.6 | 17.1 | 129.5 | 18.7 | 169.3 |
| Hedging derivative assets | – | – | 18.0 | 98.6 | 127.9 | 244.5 |
| **Total financial assets** | **6,000.9** | **370.1** | **1,613.2** | **7,577.7** | **30,603.0** | **46,164.9** |

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 19. Liquidity risk (continued)

| At 31 December 2020 | Up to 1 month £ million | 1-3 months £ million | 3-12 months £ million | 1-5 years £ million | Over 5 years £ million | Total Carrying Value £ million |
|---|---|---|---|---|---|---|
| Financial liabilities measured at amortised cost: | | | | | | |
| Customer deposits | 32,041.5 | 342.4 | 875.2 | 1,116.2 | – | 34,375.3 |
| Borrowings from central banks | 0.8 | 900.0 | 1,315.0 | 850.0 | – | 3,065.8 |
| Debt securities in issue | – | 0.4 | – | 1,698.8 | – | 1,699.2 |
| Subordinated liabilities | – | – | 3.4 | 387.9 | – | 391.3 |
| Lease liabilities | – | – | 2.6 | 34.3 | 86.4 | 123.3 |
| Other financial liabilities | 51.6 | – | – | – | – | 51.6 |
| Derivative liabilities at fair value through profit or loss | 2.4 | 0.3 | 12.4 | 157.0 | 130.2 | 302.3 |
| Hedging derivative liabilities | – | 3.2 | 4.9 | 71.9 | 145.2 | 225.2 |
| Other liabilities(1) | 196.0 | – | 87.0 | 66.1 | 117.0 | 466.1 |
| **Total liabilities** | 32,292.3 | 1,246.3 | 2,300.5 | 4,382.2 | 478.8 | 40,700.1 |
| | | | | | | |
| Financial assets at amortised cost: | | | | | | |
| Cash, cash balances at central banks and demand deposits | 5,056.6 | – | – | – | – | 5,056.6 |
| Debt securities | 3.1 | 0.6 | 1.5 | 379.7 | 738.8 | 1,123.7 |
| Loans and advances to customers | 877.1 | 288.6 | 1,354.6 | 6,676.4 | 24,121.2 | 33,317.9 |
| Loans to credit institutions | 41.8 | – | – | 1.5 | – | 43.3 |
| Loans to central banks | 120.9 | – | – | – | – | 120.9 |
| Other advances | 220.2 | – | – | – | – | 220.2 |
| Financial assets at fair value through other comp. income | 0.3 | 2.7 | 7.4 | – | 1,486.5 | 1,496.9 |
| Derivative assets at fair value through profit or loss | 0.8 | 0.6 | 5.8 | 180.7 | 10.4 | 198.3 |
| Hedging derivative assets | – | – | 4.4 | 70.6 | 64.9 | 139.9 |
| Other assets(2) | 157.1 | 3.8 | 21.2 | 167.8 | 339.1 | 689.0 |
| **Total assets** | 6,477.9 | 296.3 | 1,394.9 | 7,476.7 | 26,760.9 | 42,406.7 |

(1) Other liabilities comprise fair value adjustments for portfolio hedged risk, provisions and other liabilities.
(2) Other assets comprise fair value adjustments for portfolio hedged risk, property and equipment, intangible assets, deferred tax assets and other assets.

Expected cash flows on customer deposits and loans and advances to customers vary significantly from the contractual cash flows shown in the table above. Customer deposits are largely repayable on demand but have proven to be a stable source of funding. Loans and advances to customers comprise of a large proportion of mortgages which mature earlier than the contractual maturity as customers take advantage of early redemption options.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 19. Liquidity risk (continued)

Contractual maturities for financial liabilities form an important source of information for the management of liquidity risk. The table below analyses financial liabilities and commitments by relevant contractual maturity grouping on an undiscounted future cash flow basis, which includes estimated interest payments.

| At 31 December 2021 | Up to 1 month £ million | 1-3 months £ million | 3-12 months £ million | 1-5 years £ million | Over 5 years £ million | Total £ million |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Financial liabilities measured at amortised cost: | | | | | | |
| Customer deposits | **34,251.0** | **154.2** | **798.4** | **762.9** | **–** | **35,966.5** |
| Borrowings from central banks | **–** | **13.8** | **–** | **5,537.6** | **–** | **5,551.4** |
| Debt securities in issue | **–** | **5.4** | **516.4** | **1,224.7** | **504.1** | **2,250.6** |
| Subordinated liabilities | **–** | **2.6** | **7.8** | **333.6** | **–** | **344.0** |
| Lease liabilities | **0.2** | **5.1** | **15.9** | **70.3** | **79.3** | **170.8** |
| Other financial liabilities | **194.3** | **–** | **–** | **–** | **–** | **194.3** |
| Loan commitments | **3,926.7** | **285.6** | **1,977.8** | **44.7** | **232.6** | **6,467.4** |
| **Total non-derivative financial liabilities** | **38,372.2** | **466.7** | **3,316.3** | **7,973.8** | **816.0** | **50,945.0** |
| Derivative financial instruments - outflows | **6.6** | **24.4** | **97.3** | **470.8** | **168.1** | **767.2** |
| Derivative financial instruments - inflows | **(0.7)** | **(10.4)** | **(54.4)** | **(288.4)** | **(110.6)** | **(464.5)** |
| **Total financial liabilities** | **38,378.1** | **480.7** | **3,357.8** | **8,156.2** | **873.5** | **51,247.7** |

| At 31 December 2020 | Up to 1 month £ million | 1-3 months £ million | 3-12 months £ million | 1-5 years £ million | Over 5 years £ million | Total £ million |
|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | |
| Financial liabilities measured at amortised cost: | | | | | | |
| Customer deposits | 32,043.7 | 343.5 | 900.7 | 1,127.1 | – | 34,415.0 |
| Borrowings from central banks | 0.8 | 900.2 | 1,316.6 | 850.3 | – | 3,067.9 |
| Debt securities in issue | – | 7.6 | 23.0 | 1,750.1 | – | 1,780.7 |
| Subordinated liabilities | – | – | 396.1 | – | – | 396.1 |
| Lease liabilities | 0.2 | 6.4 | 17.3 | 75.5 | 29.4 | 128.8 |
| Other financial liabilities | 51.6 | – | – | – | – | 51.6 |
| Loan commitments | 3,847.4 | 172.0 | 1,972.4 | 25.7 | 234.0 | 6,251.5 |
| **Total non derivative financial liabilities** | 35,943.7 | 1,429.7 | 4,626.1 | 3,828.7 | 263.4 | 46,091.6 |
| Derivative financial instruments - outflows | 15.3 | 97.6 | 100.4 | 282.4 | 205.4 | 701.1 |
| Derivative financial instruments - inflows | (1.2) | (1.9) | (4.4) | (45.0) | (121.0) | (173.5) |
| **Total financial liabilities** | 35,957.8 | 1,525.4 | 4,722.1 | 4,066.1 | 347.8 | 46,619.2 |

The amounts shown are the net amounts for those derivatives that are net settled, which comprises the majority of TSB's derivative financial instruments. Gross nominal inflows and outflows are presented for derivatives that have simultaneous gross settlement such as cross currency swaps.

### 20. Capital resources

TSB maintains capital resources which exceed regulatory requirements and which seek to support the strategic growth of the business, and ensure that TSB is able to absorb losses under stressed conditions. Capital risk is managed under a framework where risk appetite is set and approved annually by the Board. A series of metrics is used to monitor capital against early warning indicators with regular reporting in place to update and inform senior management. Further information on capital resources is shown on pages 8 and 9 in the Financial performance in 2021 section of the Strategic report. The table below presents TSB's regulatory capital resources.

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Shareholder's equity | **1,849.9** | 1,706.6 |
| Regulatory deductions | **(136.6)** | (125.2) |
| **Common Equity Tier 1/Total Tier 1 capital** | **1,713.3** | 1,581.4 |
| Tier 2 capital | **305.9** | 432.8 |
| **Total capital resources** | **2,019.2** | 2,014.2 |

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 21. Market risk

**Definition and exposure**
Market risk is the risk of a reduction in earnings, value or reserves caused by changes in the prices of financial instruments. TSB's market risk consists primarily of exposure to changes in interest rates. Interest rate risk is the risk that the net value of, or net income arising from, the firm's assets and liabilities is impacted as a result of changes to interest rates. Interest rate risk can also arise as a result of changes in customer behaviour, which may affect the maturity profiles of TSB's assets and liabilities. TSB's exposure to changes in interest rates includes the margin between customer and market rates. This includes the potential impact on earnings and value that could occur when, if rates fall, liabilities cannot be re-priced as quickly or by as much as assets.

**Management and measurement**
Risk exposure across TSB is monitored monthly using, primarily, net interest income and earnings sensitivity. This methodology considers all re-pricing mismatches in the current balance sheet and calculates the change in net interest income that would result from a set of defined interest rate shocks. A limit structure exists to ensure that risks stemming from residual positions or from changes in assumptions about customer behaviour remain within risk appetite.

A 12 month view of the sensitivity of net interest income is calculated on the basis of TSB's current consolidated balance sheet with re-pricing dates adjusted according to behavioural assumptions. At 31 December 2021, the projected change in 12 month net interest income in response to an immediate parallel shift in all relevant interest rates, market and administered, would be an increase of £12.5 million (2020: £18.4 million) from a 25bps increase in rates, and an increase of £0.9 million (2020: £18.6 million loss) from a 25bps decrease. The measure assumes all interest rates, for all currencies and maturities, move at the same time and by the same amount.

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

| | 2021 | | | | 2020 | | | |
|---|---|---|---|---|---|---|---|---|
| **Derivative financial instruments not in hedge accounting relationships** | Contract/ notional amount £ million | Assets fair value £ million | Liabilities fair value £ million | Gain/(loss) recognised in profit or loss £ million | Contract/ notional amount £ million | Assets fair value £ million | Liabilities fair value £ million | Gain(loss) recognised in profit or loss £ million |
| Interest rate swaps | **24,964.2** | **168.4** | **(156.5)** | **(2.5)** | 20,790.4 | 198.3 | (299.6) | (0.5) |
| Foreign exchange forwards | – | – | – | – | – | – | – | – |
| Equity forwards and options | **3.2** | **0.9** | – | **2.1** | 5.7 | – | (2.7) | (4.5) |
| **Total** | **24,967.4** | **169.3** | **(156.5)** | **(0.4)** | 20,796.1 | 198.3 | (302.3) | (5.0) |

| | 2021 | | | | 2020 | | | |
|---|---|---|---|---|---|---|---|---|
| **Hedging derivative financial instruments** | Contract/ notional amount £ million | Assets fair value £ million | Liabilities fair value £ million | Change in fair value used for calculating hedge ineffectiveness £ million | Contract/ notional amount £ million | Assets fair value £ million | Liabilities fair value £ million | Change in fair value used for calculating hedge ineffectiveness £ million |
| **(Fair value hedges)** | | | | | | | | |
| **Interest rate risk** | | | | | | | | |
| Interest rate swaps | **21,947.4** | **235.6** | **(136.3)** | **174.9** | 18,658.5 | 139.9 | (216.7) | (116.8) |
| **(Cash flow hedges)** | | | | | | | | |
| **Interest rate and credit risk** | | | | | | | | |
| Forward settlement contracts | **200.0** | **2.3** | **(0.5)** | **12.1** | 140.9 | – | (2.2) | (12.9) |
| **Interest rate risk** | | | | | | | | |
| Interest rate swaps | **175.0** | **6.6** | **–** | **11.8** | 185.0 | – | (6.3) | (21.4) |
| **Total** | **22,322.4** | **244.5** | **(136.8)** | **198.8** | 18,984.4 | 139.9 | (225.2) | (151.1) |

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 21. Market risk (continued)

**Risk management**

Where all relevant criteria are met, hedge accounting is applied to remove the accounting mismatch between the hedging instrument and the hedged item. Such derivatives are presented on the balance sheet as hedging derivative financial instruments. Where derivatives do not meet the hedge accounting criteria they are presented on the balance sheet as derivative financial instruments not included in hedge accounting relationships.

TSB transacts derivatives largely to economically hedge interest rate risk. TSB hedges SONIA benchmark interest rate risk using both fair value hedges and cash flow hedges. As a result of TSB's dynamic hedging strategies described below, the gain on derivatives at fair value through profit or loss in respect of interest rate risk of £1.7 million (2020: £0.5 million loss) should be considered in conjunction with the loss of £4.8 million (2020: £7.7 million gain) from the amortisation of accumulated adjustments on the hedged items for which hedge accounting no longer applies.

**IBOR reform**

*Background*

IBOR reform refers to the global reform and replacement of interbank offered rates (IBOR) with alternative interest rate benchmark reference rates. In order to manage the transition, TSB established a cross-functional Reference Rate Replacement Steering Committee in 2019, which reported to the Asset & Liability Committee. The Reference Rate Replacement Steering Committee primarily focused on evaluating TSB's exposure to financial instruments and other contracts that were impacted by IBOR reform and oversaw their amendment or replacement. In addition, the committee considered the impact of IBOR reform on interest rate risk management to enable TSB to take the necessary actions in response ahead of the transition deadline.

During 2021, swaps with a notional amount of £16,892.0 million (2020: £1,517.5 million) were replaced with economically equivalent swaps that reference SONIA. At 31 December 2021, TSB had no residual exposure to financial instruments that referenced LIBOR.

*Hedge accounting policy*

TSB has adopted the IASB's 'Interest Rate Benchmark Reform – Phase 2' (the Phase 2 Amendment). This permits fair value hedge relationships to persist where a LIBOR swap was replaced with a SONIA equivalent, as the replacement is considered to be undertaken solely due to IBOR reform and the replacement SONIA swap is economically equivalent to the original LIBOR swap. In addition, TSB has applied the relief which permits amendment of the hedging documentation to reference SONIA and to revise the description of the hedged item. TSB has also applied the relief which permits the amount in the cash flow hedge reserve relating to a dedesignated hedge to be deemed to be based on the alternative benchmark rate, on which the future cash flows will be based.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 21. Market risk (continued)

**Hedge accounting overview**
The profile of interest risk being managed is dynamic, changing in response to business activity and is economically hedged with derivatives. Where natural offsets occur, these derivatives are not designated in hedge accounting relationships. The remaining derivatives may be designated in a hedge accounting relationship to minimise profit volatility. Hedge relationships are considered effective where changes in the hedged item offset changes in the hedging instrument to within an 80% to 125% ratio. Effectiveness tests are performed at inception and on a monthly basis using either dollar offset, linear regression or critical terms match, depending on the nature of the hedged items. Ineffectiveness arising on hedge relationships can arise due to a number of factors which include basis mismatch, maturity mismatch, credit valuation adjustments and cash flow timing mismatch between the hedged item and hedging instrument.

*Macro fair value hedge accounting – fixed rate mortgages and demand deposits*
Pay fixed, receive floating interest rate swaps are typically designated as a portfolio fair value hedge of fixed rate mortgage assets and receive fixed, pay floating derivatives are typically designated as a portfolio fair value hedge of fixed rate customer deposits. As interest rate risk management is dynamic, TSB's approach is to dedesignate these hedge relationships and redesignate new relationships on a monthly basis. The provisions of the UK adopted version of IAS 39 mean that ineffectiveness arising due to unexpected prepayments need not be recognised though profit or loss, so long as hedge designations are made in such a way to minimise their impact.

*Micro fair value hedge accounting – subordinated debt and debt securities*
TSB has issued fixed rate subordinated debt and purchased fixed rate debt securities as part of its Treasury management strategy, and these are hedged with interest rate swaps and designated in a fair value hedge.

*Cash flow hedge accounting – forward bond sales*
TSB seeks to minimise interest rate and credit risk arising on purchased hold to collect and sell debt securities, using forward settlement contracts. The sales proceeds represent a forecast transaction which is hedged by the forward contract. At 31 December 2021, forward settlement agreements with a notional amount of £200.0 million (2020: £140.9 million) were expected to mature within one year (2020: within one year) at a price of 114% of the notional amount (2020: 160%).

*Cash flow hedge accounting – covered bonds*
Interest rate risk on issued floating rate covered bonds is hedged using interest rate swaps that exchange floating rate cash flows for fixed rate cash flows. At 31 December 2021, hedged forecast covered bond cash flows were expected to mature after ten years (2020: after ten years).

*Exposures covered by hedging accounting strategies*
The following table contains details of the hedged exposures covered by TSB's hedging strategy:

| 2021 | Risk type | Carrying amount of hedged item assets/(liability) £ million | Accumulated fair value hedge adj. on hedged item £ million | Balance sheet line item that includes the hedged item | Change in fair value for calculating hedge ineffectiveness £ million | Cash flow hedge reserve continuing hedges £ million |
|---|---|---|---|---|---|---|
| **Fair value hedges** | | | | | | |
| Portfolio hedged risk: | | | | | | |
| Demand deposits | Interest rate | **(6,512.4)** | **63.6** | **Customer deposits** | **179.2** | **n/a** |
| Fixed rate mortgages | Interest rate | **12,332.7** | **(109.3)** | **Loans & adv to customers** | **(183.4)** | **n/a** |
| Individual hedged risk: | | | | | | |
| Subordinated liabilities | Interest rate | **(291.8)** | **8.3** | **Subordinated liabilities** | **11.2** | **n/a** |
| Debt securities | Interest rate | **841.0** | **–** | **Financial assets at FVOCI** | **(92.3)** | **n/a** |
| Debt securities | Interest rate | **1,921.8** | **(56.5)** | **Financial assets at amortised cost** | **(87.7)** | **n/a** |
| | | | | | **(173.0)** | |
| **Cash flow hedges** | | | | | | |
| Debt securities | Interest rate/credit | **228.0** | **n/a** | **Financial assets at FVOCI** | **(11.8)** | **1.7** |
| Covered bonds issued | Interest rate | **185.0** | **n/a** | **Debt securities in issue** | **(12.2)** | **(10.7)** |
| | | | | | **(24.0)** | **(9.0)** |

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 21. Market risk (continued)

*Exposures covered by hedging accounting strategies (continued)*

| 2020 | Risk type | Carrying amount of hedged item assets/(liability) £ million | Accumulated fair value hedge adj. on hedged item £ million | Balance sheet line item that includes the hedged item | Change in fair value for calculating hedge ineffectiveness £ million | Cash flow hedge reserve continuing hedges £ million |
|---|---|---|---|---|---|---|
| **Fair value hedges** | | | | | | |
| Portfolio hedged risk: | | | | | | |
| Demand deposits | Interest rate | (6,123.5) | (117.0) | **Customer deposits** | (69.9) | n/a |
| Fixed rate mortgages | Interest rate | 10,545.4 | 80.2 | **Loans & adv to customers** | 58.4 | n/a |
| Individual hedged risk: | | | | | | |
| Subordinated liabilities | Interest rate | (391.3) | (3.0) | **Subordinated liabilities** | 4.9 | n/a |
| Debt securities | Interest rate | 1,271.0 | – | **Financial assets at FVOCI** | 102.2 | n/a |
| Debt securities | Interest rate | 898.0 | 31.2 | **Financial assets at amortised cost** | 19.8 | n/a |
| | | | | | 115.5 | n/a |
| **Cash flow hedges** | | | | | | |
| Debt securities | Interest rate/credit | 225.8 | n/a | **Financial assets at FVOCI** | 12.9 | (2.2) |
| Covered bonds issued | Interest rate | 185.0 | n/a | **Debt securities in issue** | 21.1 | (25.3) |
| | | | | | 34.0 | (27.5 |

The amount of fair value hedge adjustments remaining on the balance sheet relating to hedges which have been dedesignated is £110.4 million (2020: £116.0 million).

*Hedge accounting ineffectiveness*

The following table contains information regarding the effectiveness of the hedging relationships designated by TSB, as well as the impacts on profit or loss and other comprehensive income:

| | | | | | Amounts reclassified from reserves to P&L as: | |
|---|---|---|---|---|---|---|
| 2021 | Risk type | Hedge ineffectiveness recognised in P&L £ million | Gain/(loss) recognised in OCI £ million | P&L line item that includes hedge ineffectiveness | Hedged item affected P&L £ million | P&L line item that includes reclassified amount £ million |
| Fair value hedges | Interest rate | **(2.0)** | **n/a** | Gains from hedge accounting | **n/a** | n/a |
| Cash flow hedges | Interest rate / credit risk | – | **12.2** | n/a | **(8.2)** | Other income |
| Cash flow hedges | Interest rate | **(0.8)** | **11.8** | Gains from hedge accounting | **2.8** | Other income |
| | | **(2.8)** | **24.0** | | **(5.4)** | |
| 2020 | | | | | | |
| Fair value hedges | Interest rate | (1.3) | – | Gains from hedge accounting | n/a | n/a |
| Cash flow hedges | Interest rate / credit risk | – | (12.9) | n/a | 7.7 | Other income |
| Cash flow hedges | Interest rate | (0.3) | (21.1) | Gains from hedge accounting | 1.7 | Other income |
| Cash flow hedges | Foreign exchange | – | 12.5 | n/a | (12.3) | Other income |
| | | (1.6) | (21.5) | | (2.9) | |

Losses from hedge accounting in the income statement of £2.4 million (2020: £5.8 million) comprise hedge ineffectiveness of £2.8 million gain (2020: £(1.6) million) and £5.2 million loss (2020: £7.4 million) of amortisation of de-designated cash flow hedges and fair value hedge adjustments on hedged items for which hedge accounting had previously been discontinued.

# Notes to the consolidated financial statements

## Managing financial risk (continued)

### 21. Market risk (continued)

*Reconciliation of reserves in respect of hedge accounting*
The following table shows a reconciliation of each component of equity and an analysis of other comprehensive income in respect of hedge accounting:

| | 2021 Fair value reserve £ million | 2021 Cash flow hedge reserve £ million | 2020 Fair value reserve £ million | 2020 Cash flow hedge reserve £ million |
|---|---|---|---|---|
| **Balance as at 1 January** | **11.6** | **(20.2)** | 13.6 | (2.5) |
| Amounts recognised in other comprehensive income: | | | | |
| *Fair value hedges of interest rate risk* | | | | |
| Changes in fair value of purchased debt securities | **(86.1)** | **n/a** | 117.0 | n/a |
| Accumulated fair value hedge adjustment | **92.3** | **n/a** | (102.2) | n/a |
| | **6.2** | **n/a** | 14.8 | n/a |
| Net amounts reclassified to profit or loss | **(7.0)** | **n/a** | (17.0) | n/a |
| Taxation | **0.3** | **n/a** | 0.2 | n/a |
| | | | | |
| *Cash flow hedge of interest rate and credit risk* | | | | |
| Effective portion of changes in fair value of forward contracts | **n/a** | **12.2** | n/a | (12.9) |
| Amounts reclassified from reserves to profit or loss | **n/a** | **(8.2)** | n/a | 7.7 |
| Taxation | **n/a** | **(1.0)** | n/a | 1.4 |
| | | | | |
| *Cash flow hedges of interest rate* | | | | |
| Effective portion of changes in fair value of interest rate swaps | **n/a** | **11.8** | n/a | (21.1) |
| Amounts reclassified from reserves to profit or loss | **n/a** | **2.8** | n/a | 1.7 |
| Taxation | **n/a** | **(4.0)** | n/a | 5.3 |
| | | | | |
| *Cash flow hedges of foreign exchange risk* | | | | |
| Effective portion of changes in fair value of cross currency swaps | **n/a** | **n/a** | n/a | 12.5 |
| Amounts reclassified from reserves to profit or loss | **n/a** | **n/a** | n/a | (12.3) |
| **Balance as at 31 December** | **11.1** | **(6.6)** | 11.6 | (20.2) |

**Offsetting financial assets and financial liabilities**
The following information relates to financial assets and liabilities which have not been set off but for which TSB has enforceable master netting agreements in place with counterparties.

| | | | | Related amounts where set off in the balance sheet is not permitted | | |
|---|---|---|---|---|---|---|
| **At 31 December 2021** | Gross amounts £ million | Amounts offset £ million | Net amounts reported on the balance sheet £ million | Related financial instrument amounts not offset £ million | Cash collateral (received)/ pledged(1) £ million | Net amount £ million |
| Derivative financial assets | **413.8** | **–** | **413.8** | **(276.3)** | **(136.9)** | **0.6** |
| Derivative financial liabilities | **293.3** | **–** | **293.3** | **(276.3)** | **(17.0)** | **–** |
| | | | | | | |
| **At 31 December 2020** | | | | | | |
| Derivative financial assets | 338.2 | – | 338.2 | (338.2) | – | – |
| Reverse repurchase agreements | 225.8 | (225.8) | – | – | – | – |
| Other assets | 347.8 | (192.6) | 155.2 | – | – | 155.2 |
| | | | | | | |
| Derivative financial liabilities | (527.5) | – | (527.5) | 338.2 | 189.3 | – |
| Repurchase agreements | (225.8) | 225.8 | – | – | – | – |
| Other liabilities (note 30) | (388.6) | 192.6 | (196.0) | – | – | (196.0) |

(1) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value and this amount is limited to the net balance sheet exposure in order to exclude any over collateralisation. The collateral amount presented includes non-cash collateral of £nil (2020: £8.4 million).

# Notes to the consolidated financial statements

## Other important disclosures

**Accounting policies relevant to this section**

**(k) Share capital**
Shares are classified as equity instruments when there is no contractual obligation to deliver cash or other assets to another entity and the shares present a residual interest in the net assets of the issuer. Ordinary shares are classified as equity.

**(l) Provisions and contingent liabilities and assets**
Provisions are recognised in respect of present obligations arising from past events where it is probable that outflows of resources will be required to settle the obligations and they can be reliably estimated.

Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or those present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless they are remote.

Contingent assets are possible assets that arise from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within TSB's control. These are recognised only when it is virtually certain that an inflow of economic benefits will arise.

**(m) Premises and equipment**
Property, plant and equipment are recognised at cost less accumulated depreciation. Cost includes the original purchase price of the assets and the costs attributable to bringing the asset into working condition for its intended use. Subsequent expenditure is capitalised only if it is probable that future economic benefits associated with the expenditure will flow to TSB. The value of land (included in premises) is not depreciated. Depreciation on other premises and equipment is calculated using the straight-line method to allocate the difference between the cost and the residual value over their estimated useful lives, as follows:

- Freehold premises and leasehold right of use assets: shorter of 50 years or the remaining period of the lease.
- Leasehold improvements: shorter of 10 years and, if lease renewal is not likely, the remaining period of the lease.
- Fixtures and furnishings: 0-10 years.
- Other equipment and motor vehicles: 2-8 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In the event that an asset's carrying amount is determined to be greater than its recoverable amount it is written down immediately. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

**(n) Leases**
At inception of a contract TSB assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, TSB assesses whether: (a) the contract involves the use of an identified asset; (b) TSB has the right to substantially all of the economic benefits from use of the asset throughout the period of use; and (c) TSB has the right to direct the use of the asset.

At inception or on reassessment of a contract that contains a lease component, TSB allocates the consideration in the contract to each lease component on the basis of their relative stand-alone prices.

TSB recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The estimated useful lives of right-of-use assets are determined on a similar basis as those of property and equipment but also include consideration of the lease term. The right-of-use asset is written down by any impairment losses, for example where a leased property will be closed before the end of the lease term, and is adjusted for certain remeasurements of the lease liability. No lease liability or related right of use asset is recognised in respect of short term leases, of less than one year, or leases of low value assets. As permitted by accounting standards, the cost of such leases are expensed as incurred.

# Notes to the consolidated financial statements

## Other important disclosures (continued)

**Accounting policies relevant to this section (continued)**

**(n) Leases (continued)**

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using TSB's incremental borrowing rate. The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recognised in the consolidated income statement if the carrying amount of the right-of-use asset has been reduced to zero.

**(o) Intangible assets**

Intangible assets held by TSB consist of internally developed computer software which is held at cost less accumulated amortisation and impairment. Software development costs are capitalised if it is probable that the asset created will generate future economic benefits. Costs incurred to establish technological feasibility or to maintain existing levels of performance are recognised as an expense.

Computer software intangible assets are amortised using the straight line method over their estimated useful lives of between 3 and 5 years. Amortisation commences when the assets are ready for their intended use. Estimated useful lives are reviewed annually and adjusted, if appropriate, in the light of technological developments, usage and other relevant factors. Computer software is reviewed for indicators of impairment at each reporting date and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Where the carrying amount is not recoverable the asset is written down immediately to the estimated recoverable amount.

### 22. Shareholder's equity

| | Share capital £ million | Share premium £ million | Merger reserve £ million | Capital reorg-anisation reserve £ million | Capital reserve £ million | Fair value reserve £ million | Cash flow hedging reserve £ million | Retained profits £ million |
|---|---|---|---|---|---|---|---|---|
| Balance at 1 January 2020 | 5.0 | 965.1 | 616.5 | (1,311.6) | 410.0 | 13.6 | (2.5) | 1,189.9 |
| Net change in fair value reserve | – | – | – | – | – | (2.0) | – | – |
| Net change in cash flow hedging reserve | – | – | – | – | – | – | (17.7) | – |
| Loss for the year | – | – | – | – | – | – | – | (159.7) |
| **At 31 December 2020** | 5.0 | 965.1 | 616.5 | (1,311.6) | 410.0 | 11.6 | (20.2) | 1,030.2 |
| Net change in fair value reserve | **–** | **–** | **–** | **–** | **–** | **(0.5)** | **–** | **–** |
| Net change in cash flow hedging reserve | **–** | **–** | **–** | **–** | **–** | **–** | **13.6** | **–** |
| Profit for the year | **–** | **–** | **–** | **–** | **–** | **–** | **–** | **130.2** |
| **At 31 December 2021** | **5.0** | **965.1** | **616.5** | **(1,311.6)** | **410.0** | **11.1** | **(6.6)** | **1,160.4** |

At 31 December 2021, TSB Banking Group plc had in issue 500.0 million (2020: 500.0 million) one pence ordinary shares authorised, allotted and fully paid up.

The merger reserve and capital reorganisation reserves were established in 2014 upon TSB Banking Group plc issuing new shares in exchange for the acquisition of the entire share capital of TSB Bank plc. The issuance was recorded at the carrying amount of the net assets of TSB Bank plc at the date of acquisition and resulted in a transfer to the share premium reserve of a minimum amount required by the Companies Act 2006. The difference between the amount transferred to share capital and share premium and the carrying amount of the net assets of TSB Bank plc was transferred to the merger reserve. The capital reorganisation reserve was established at this time to reflect the effect of TSB Banking Group plc becoming the new holding company of TSB Bank plc by means of this share for share exchange.

The capital reserve represents a capital contribution received in 2013 from a, then, parent company. The fair value reserve represents the unrealised change in the value of financial assets at fair value through other comprehensive income since the instrument's initial recognition. The cash flow hedging reserve represents the cumulative gains and losses on effective cash flow hedging instruments that will be recycled to the income statement when the hedged transactions affect profit or loss.

## Other important disclosures (continued)

### 23. Contingent liabilities

**Significant judgement**

**Regulatory and conduct matters**

During 2018, the FCA and PRA commenced a formal joint investigation in connection with the handling of the migration of data and IT systems. While regulators have indicated that they are in the closing stages of their analysis, the investigation is ongoing and it is not yet possible to determine its outcome.

Further, as explained in note 29 on page 110, management and the FCA are investigating conduct related matters in TSB's collection and recoveries function for which a provision covering the estimated redress costs has been recognised. It is not, however, currently possible to conclude if any regulatory penalty will be levied, or the timing of any potential penalty, and therefore no costs for an estimated penalty have been recognised in these financial statements.

More broadly, during the ordinary course of business, TSB may be subject to other complaints and threatened or actual legal proceedings brought by customers that may result in legal and regulatory reviews, challenges, investigations and enforcement actions. Any such material cases are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of incurring a liability. TSB does not disclose amounts in relation to contingent liabilities associated with such claims where the likelihood of any payment is remote. TSB also does not disclose an estimate of the potential financial impact or effect on TSB of contingent liabilities where it is not currently practicable to do so. TSB does not expect the ultimate resolution of any current complaints, threatened or actual legal proceedings, regulatory or other matters to have a material adverse impact on its financial position in relation to any additional issues not explicitly disclosed above.

### 24. Related party transactions

TSB's related parties include key management personnel, Sabadell and other Sabadell Group companies.

**(i) Key management personnel**

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of TSB which is the Board and Executive Committee. Key management personnel compensation is shown in the table below.

| | 2021<br>£ 000 | 2020<br>£ 000 |
|---|---|---|
| Short term employee benefits | **9,191** | 5,597 |
| Post-employment benefits | **802** | 730 |
| Other long term benefits | **–** | – |
| Share based payments | **574** | – |
| Payments for loss of office | **–** | 459 |
| **Total** | **10,567** | 6,786 |

The tables below detail, on an aggregated basis, related party transactions, balances outstanding at the year end and related income and expense in respect of key management personnel.

| | 2021<br>£ 000 | 2020<br>£ 000 |
|---|---|---|
| **Loans** | | |
| At 1 January | **33** | 11 |
| Advances (includes key management personnel appointed during the year) | **793** | 216 |
| Interest charged during the year | **1** | – |
| Repayments made during the year (including key management personnel resigned during the year) | **(156)** | (194) |
| **At 31 December** | **671** | 33 |

The loans attracted interest at customer rates and were made in the ordinary course of business. Expected credit losses are assessed to be immaterial.

# Notes to the consolidated financial statements

## Other important disclosures (continued)

### 24. Related party transactions (continued)

**(i) Key management personnel (continued)**

| | 2021 £ 000 | 2020 £ 000 |
|---|---|---|
| **Deposits** | | |
| At 1 January | **1,913** | 1,796 |
| Deposits made during the year (includes key management personnel appointed during the year) | **5,577** | 4,471 |
| Interest expense on deposits | **1** | 7 |
| Withdrawals made during the year (including key management personnel resigned during the year) | **(7,244)** | (4,361) |
| **At 31 December** | **247** | 1,913 |

Deposits placed by key management personnel are at customer rates and were made in the ordinary course of business.

**(ii) Transactions and balances with Sabadell Group companies**

*Operational IT costs*
Operating expenses of £59.0 million (2020: £124.8 million) were incurred in respect of services provided by Sabis, TSB's parent company's IT supplier, under the Outsourced Services Agreement (OSA) for running and developing the banking platform.

*Residual IT Migration related balances*
In connection with the IT migration in 2018, the Migration Services Agreement (MSA) and OSA contracts provided TSB with the right to seek recovery of eligible losses for breach of contract up to the level of liability caps in each agreement. In December 2021, a Settlement Agreement was entered in to by the respective parties. This represented full and final settlement of TSB's £192.6 million claim against Sabis, which extinguished a corresponding withheld amount that was payable by TSB to Sabis under the MSA and OSA contracts. At 31 December 2021, the aggregate liability to Sabis was £6.9 million, representing business as usual amounts payable under the OSA contract (note 30 on page 111).

At 31 December 2020, the respective parties had reached provisional agreement, subject to mutual reservations of rights while negotiations were concluded, to recognise an aggregate estimated recovery under the agreements of £192.6 million, reflecting the maximum recovery amount under the contracts. As TSB intended to settle on a net basis, the residual MSA liability of £100.0 million was presented on the statement of financial position net of the recovery of £100.0 million. The amount payable to Sabis in respect of the OSA and other change services of £113.9 million was presented net of recovery of £92.6 million. Taken together, at 31 December 2020, the aggregate liability to Sabis was £21.3 million (note 30).

*Senior unsecured debt securities*
In December 2020, TSB Banking Group plc issued £450.0 million of floating rate notes with a maturity date of June 2023 to its parent company, Sabadell, at an issue price of 100% of the principal amount. The notes pay interest at SONIA plus 2.1%. Interest expense of £9.7 million (2020: £0.1 million) was recognised and £0.1 million was payable at 31 December 2021 (2020: £0.1 million).

*Subordinated liabilities*
In March 2021, TSB Banking Group plc issued £300.0 million fixed-to-floating rate callable subordinated Tier 2 capital notes, due to mature in March 2031, to its parent company, Sabadell. These were issued at a price of 100% of the principal amount. The notes pay interest at a fixed rate of 3.449% per annum payable quarterly in arrears. TSB has the option to redeem these notes in March 2026, subject to approval of the PRA. Interest expense of £7.8 million (2020: £nil) was recognised and £0.1 million was payable at 31 December 2021 (2020: £nil).

*Economic hedging of share based compensation liability*
TSB holds forward purchase agreements with Sabadell to acquire 8.5 million (2020: 10.5 million) Sabadell shares to satisfy estimated requirements under various share based compensation arrangements. At 31 December 2021, this forward agreement had an asset fair value of £0.9 million (2020: liability fair value of £2.7 million) and TSB had received cash collateral from Sabadell of £0.7 million (2020: TSB had placed cash collateral with Sabadell of £2.7 million).

*Other transactions and balances*
Sabadell acts as an intermediary for TSB in respect of international payments and TSB has nostro accounts as a result of this arrangement which had a net balance due from Sabadell of £2.1 million (2020: £1.9 million). Sabadell acts as guarantor to TSB's borrowings under the TFSME. Under this arrangement guarantee fees of £5.2 million (2020: nil) were recognised and £2.5 million (2020: nil) was payable at 31 December 2021.

# Notes to the consolidated financial statements

## Other important disclosures (continued)

### 25. Property and equipment

| | Property £ million | Equipment £ million | Property Right of use leasing asset £ million | Total £ million |
|---|---|---|---|---|
| **Cost** | | | | |
| At 1 January 2020 | 245.8 | 111.4 | 167.3 | 524.5 |
| Additions | 10.5 | 23.8 | 5.1 | 39.4 |
| Disposals | (22.3) | (12.4) | (5.2) | (39.9) |
| Lease term remeasurement (note 26) | – | – | 1.5 | 1.5 |
| Write-offs | – | – | – | – |
| At 31 December 2020 | **234.0** | **122.8** | **168.7** | **525.5** |
| Additions | **16.9** | **29.6** | **12.8** | **59.3** |
| Disposals | **(78.4)** | **(60.1)** | **(11.0)** | **(149.5)** |
| Lease term remeasurement (note 26) | **–** | **–** | **60.0** | **60.0** |
| **At 31 December 2021** | **172.5** | **92.3** | **230.5** | **495.3** |
| | | | | |
| **Accumulated depreciation** | | | | |
| At 1 January 2020 | 125.8 | 77.8 | 27.7 | 231.3 |
| Depreciation charge for property and equipment (note 14) | 27.8 | 14.0 | – | 41.8 |
| Depreciation charge for right of use asset (note 14) | – | – | 25.8 | 25.8 |
| Disposals | (19.3) | (12.3) | (0.7) | (32.3) |
| At 31 December 2020 | **134.3** | **79.5** | **52.8** | **266.6** |
| Depreciation charge for property and equipment (note 14) | **22.4** | **15.0** | **–** | **37.4** |
| Depreciation charge for right of use asset (note 14) | **–** | **–** | **25.1** | **25.1** |
| Disposals | **(69.8)** | **(56.0)** | **(8.3)** | **(134.1)** |
| **At 31 December 2021** | **86.9** | **38.5** | **69.6** | **195.0** |
| | | | | |
| **Carrying amount** | | | | |
| At 31 December 2020 | 99.7 | 43.3 | 115.9 | 258.9 |
| **At 31 December 2021** | **85.6** | **53.8** | **160.9** | **300.3** |

At 31 December 2021, property held for sale totalled £1.6 million (2020: £0.4 million). The net book value represented the recoverable amount and no impairment was required.

### 26. Lease liabilities

TSB's leasing activity primarily reflects leases of various offices and bank branch properties. These lease arrangements will often contain renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments. The tables below set out details of the amounts recognised in the financial statements in respect of leases:

| Lease liability | Property 2021 £ million | Property 2020 £ million |
|---|---|---|
| **Balance at 1 January** | **123.3** | 141.8 |
| Additions | **0.4** | 5.1 |
| Lease term remeasurement | **60.0** | 1.5 |
| Interest expense for the year | **2.6** | 1.3 |
| Lease payments made in the year | **(22.8)** | (26.4) |
| **Carrying amount at 31 December** | **163.5** | 123.3 |

As part of a wider strategic property review, during 2021 the lease terms of relevant properties were reassessed. This resulted in an increase in the lease liability of £60.0 million and a corresponding increase in the associated right of use assets (note 25).

The estimation of lease term requires judgement. An increase or decrease in the estimated lease term of one year would have increased/decreased the lease liability, and the corresponding right of use asset, by £8 million.

# Notes to the consolidated financial statements

## Other important disclosures (continued)

### 27. Intangible assets

| | 2021 £ million | 2020 £ million |
|---|---|---|
| **Cost** | | |
| At 1 January | **66.4** | 30.5 |
| Additions | **32.1** | 35.9 |
| Disposals | **(3.6)** | – |
| **At 31 December** | **94.9** | 66.4 |
| **Accumulated amortisation** | | |
| At 1 January | **16.9** | 10.2 |
| Amortisation charge for the year (note 14) | **7.7** | 6.7 |
| Disposals | **(1.8)** | – |
| **At 31 December** | **22.8** | 16.9 |
| **Carrying amount** | **72.1** | 49.5 |

### 28. Other assets

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Other assets and prepayments | **130.6** | 144.3 |
| Amounts recoverable under customer remediation indemnity | **6.9** | 10.9 |
| **Total other assets** | **137.5** | 155.2 |

### 29. Provisions

| | Customer redress provisions £ million | Restructuring provisions £ million | Credit impairment provisions £ million | Dilapidations provisions £ million | Total £ million |
|---|---|---|---|---|---|
| At 1 January 2021 | **66.1** | **67.8** | **19.2** | **–** | **153.1** |
| Transfers | **–** | **(7.1)** | **–** | **7.1** | **–** |
| Increase/(decrease) [(1)] | **(3.1)** | **12.7** | **(2.5)** | **13.9** | **21.0** |
| Utilisation | **(3.5)** | **(59.0)** | **–** | **(1.4)** | **(63.9)** |
| **At 31 December 2021** | **59.5** | **14.4** | **16.7** | **19.6** | **110.2** |

(1) The increase in restructuring provisions includes £2.2 million of remediation expense in respect of the collection and recovery conduct charges matter.

**Significant estimates**

*Customer redress provisions*
During 2020, management and the FCA commenced a review of support treatments offered to some customers who are, or were, in arrears and being serviced by TSB's collections and recoveries department which has identified potentially impacted customers over a period from 2013 to 2020 who may have suffered either financial loss or distress and inconvenience. While the review is not yet complete, the assessment of the potential cost of customer redress, including compensatory interest, and related operational costs has been refined during 2021. While the proposed approach to customer redress has taken account of discussions with the skilled person appointed by the FCA, it has yet to be formally agreed with the FCA.

The costs of redress are estimated to lie within a range of £49.4 million to £56.6 million (2020: £53.1 million to £57.4 million). The key judgements to which the estimate is sensitive, and which are the primary drivers of the £7.2 million range in estimated cost, relate to:

- a small number of cohorts of customers where the cost of redress lies within an estimated range of between £2.0 million and £4.2 million, dependent on assumed rates of redress and the number of impacted customers; and
- the degree to which previously applied fees and charges have been already refunded resulting in a reduction in estimated costs of between £2.0 million and £5.4 million.

A provision of £54.3 million (2020: £55.0 million) is carried and is expected to be utilised over the next two years.

# Notes to the consolidated financial statements

## Other important disclosures (continued)

### 29. Provisions (continued)

**Significant estimate (continued)**

*Dilapidation provisions*
During 2021, the dilapidation provision was reassessed as part a wider strategic property review. This assessment resulted in an increase of £12.8 million in the provision, included within the increase of £13.9 million reported in the table on page 110. In addition, £7.1 million of dilapidation provision previously recognised as part of previous restructuring was reclassified to this category. The estimation of the amount and timing of payments to landlords as part of contractual dilapidation obligations requires judgement. In estimating the provision, experience gained from recent branch closures was used, together with supporting evidence from property advisors. An increase/decrease of 10% to the average dilapidation rate per leasehold branch would have increased/decreased the provision balance at 31 December 2021 by £2.0 million.

*Restructuring provisions*
At 31 December 2021, TSB carried provisions of £23.2 million (2020: £67.8 million) in respect of estimated costs to restructure the Bank as part of TSB's strategy. This included estimated costs in respect of the closure of 70 branches that was announced in November 2021 and residual costs in respect of earlier phases of previously announced branch closures. The amounts are expected to be settled during 2022.

*Credit impairment provisions*
Credit impairment provisions are in respect of off balance sheet lending commitments and primarily relates to provisions in respect of undrawn credit card limits and current account overdrafts. This provision is measured and managed as part of the overall assessment of expected credit losses. Sensitivity of total expected credit losses to alternative economic scenarios is set out in note 8 on page 77.

### 30. Other liabilities

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Amounts payable to Sabadell Group companies (note 24) | **6.9** | 21.3 |
| Accruals and deferred income | **84.8** | 87.6 |
| Share based payment liability | **5.3** | 4.1 |
| Other creditors | **99.8** | 83.0 |
| **Total other liabilities** | **196.8** | 196.0 |

### 31. Notes to the consolidated cash flow statement

The table below presents the change in liabilities arising from financing activities.

| | Borrowings from central banks £ million | Debt securities in issue £ million | Subordinated liabilities £ million | Total non customer funding £ million |
|---|---|---|---|---|
| At 1 January 2020 | 4,483.5 | 1,676.3 | 395.9 | 6,555.7 |
| Repayment of borrowings from central banks (net) | (1,410.0) | – | – | (1,410.0) |
| Repayment of securitisation funding | – | (440.2) | – | (440.2) |
| Issuance of senior unsecured debt securities | – | 450.0 | – | 450.0 |
| Exchange differences | – | 13.7 | – | 13.7 |
| Non-cash movements | (7.7) | (0.6) | (4.6) | (12.9) |
| At 31 December 2020 | **3,065.8** | **1,699.2** | **391.3** | **5,156.3** |
| Additional borrowings from central banks | **5,500.0** | **–** | **–** | **5,500.0** |
| Repayment of borrowings from central banks | **(3,065.0)** | **–** | **–** | **(3,065.0)** |
| Issue of subordinated liabilities | **–** | **–** | **300.0** | **300.0** |
| Repayment of subordinated liabilities | **–** | **–** | **(385.0)** | **(385.0)** |
| Issuance of covered bonds | **–** | **500.0** | **–** | **500.0** |
| Non-cash movements | **0.8** | **(0.1)** | **(14.5)** | **(13.8)** |
| **At 31 December 2021** | **5,501.6** | **2,199.1** | **291.8** | **7,992.5** |

# Notes to the consolidated financial statements

## Other important disclosures (continued)

### 31. Notes to the consolidated cash flow statement (continued)

The following table presents further analysis of balances in the consolidated cash flow statement:

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Increase in loans to central banks | **(22.7)** | (24.8) |
| (Increase)/decrease in loans to credit institutions | **(12.8)** | 329.9 |
| Increase in loans and advances to customers | **(4,070.2)** | (2,402.4) |
| Decrease in reverse repurchase agreements | **–** | 201.1 |
| Decrease in other advances | **139.5** | 59.4 |
| Net change in derivative financial instruments and fair value adjustment for portfolio hedged risk | **(149.0)** | (216.6) |
| Decrease/(increase) in other assets | **17.7** | (23.9) |
| (Decrease)/increase in deposits from credit institutions | **–** | 4.2 |
| Increase in customer deposits | **1,591.2** | 4,217.0 |
| Increase/(decrease) in other financial liabilities | **142.6** | (33.9) |
| (Decrease)/increase in provisions | **(40.4)** | 101.3 |
| (Decrease)/increase in other liabilities | **(0.5)** | 42.6 |
| **Change in operating assets and liabilities** | **(2,404.6)** | 2,253.9 |

| | | |
|---|---|---|
| Depreciation and amortisation | **70.2** | 74.3 |
| Impairment losses on loans and advances to customers | **2.6** | 162.7 |
| Exchange differences | **–** | 13.7 |
| Other non-cash items | **37.1** | 32.5 |
| **Non-cash and other items** | **109.9** | 283.2 |

| | | |
|---|---|---|
| **Analysis of cash and cash equivalents as shown in the balance sheet** | | |
| Cash | **100.7** | 143.6 |
| Balances with central banks | **4,741.5** | 4,910.1 |
| On demand deposits | **9.0** | 2.9 |
| **Total cash and cash equivalents** | **4,851.2** | 5,056.6 |

### 32. Approval of the consolidated financial statements

These consolidated financial statements were approved by the Board of Directors on 26 January 2022. The Company's ultimate parent company and ultimate controlling party is Banco de Sabadell, S.A. (incorporated in Spain), which is also the parent undertaking of the largest group of undertakings for which consolidated financial statements are drawn up and of which the Company is a member. Banco de Sabadell S.A. is the parent undertaking of the smallest such group of undertakings for which consolidated financial statements are drawn up and of which the Company is a member. Copies of the consolidated annual report and accounts of Banco de Sabadell S.A. are expected to be available in due course from www.grupbancsabadell.com/en/.

# Company balance sheet

## As at 31 December 2021

**Company Number: 08871766**

| | Note | 2021 £ million | 2020 £ million |
|---|---|---|---|
| **Assets** | | | |
| Non-current assets: | | | |
| Investments in subsidiaries | 4 | **1,589.4** | 1,589.4 |
| Loans to subsidiaries | 4 | **750.2** | 838.4 |
| | | **2,339.6** | 2,427.8 |
| Current assets: | | | |
| Derivative financial assets | 5 | **0.9** | – |
| Amounts due from subsidiaries | 4 | **1.5** | 0.4 |
| Other advances | | **–** | 2.7 |
| Current tax asset | | **–** | 0.4 |
| Deferred tax asset | | **0.6** | 0.7 |
| **Total assets** | | **2,342.6** | 2,432.0 |
| | | | |
| **Liabilities** | | | |
| Non-current liabilities: | | | |
| Senior unsecured debt securities | 2 | **450.1** | 450.1 |
| Subordinated liabilities | 2 | **300.1** | 388.3 |
| | | | |
| Current liabilities: | | | |
| Derivative financial liabilities | 5 | **–** | 2.7 |
| Amounts due to subsidiaries | 4 | **17.4** | 18.5 |
| Current tax liability | | **0.2** | – |
| Other financial liabilities | | **0.7** | – |
| **Total liabilities** | | **768.5** | 859.6 |
| | | | |
| **Equity** | | | |
| Share capital | 3 | **5.0** | 5.0 |
| Share premium | 3 | **965.1** | 965.1 |
| Merger reserve | 3 | **616.5** | 616.5 |
| Profit/(loss) for the year | | **1.7** | (3.0) |
| Accumulated losses brought forward | | **(14.2)** | (11.2) |
| **Shareholder's equity** | | **1,574.1** | 1,572.4 |
| | | | |
| **Total equity and liabilities** | | **2,342.6** | 2,432.0 |

The accompanying notes are an integral part of the financial statements.

No statement of comprehensive income has been shown for the Company, as permitted by section 408 of the Companies Act 2006.

The Company financial statements on pages 113 to 118 were approved by the Board of Directors on 26 January 2022 and signed on its behalf by:

**Robin Bulloch**
*Interim Chief Executive*

**Declan Hourican**
*Chief Financial Officer*

# Company statement of changes in equity

## for the year ended 31 December 2021

| | Share capital £ million | Share premium £ million | Merger reserve £ million | Accumulated losses £ million | Shareholder's equity £ million |
|---|---|---|---|---|---|
| Balance at 1 January 2020 | 5.0 | 965.1 | 616.5 | (11.2) | 1,575.4 |
| **Comprehensive loss** | | | | | |
| Total comprehensive loss for the year | – | – | – | (3.0) | (3.0) |
| Balance at 31 December 2020 | 5.0 | 965.1 | 616.5 | (14.2) | 1,572.4 |
| **Comprehensive income** | | | | | |
| Total comprehensive income for the year | **–** | **–** | **–** | **1.7** | **1.7** |
| **Balance at 31 December 2021** | **5.0** | **965.1** | **616.5** | **(12.5)** | **1,574.1** |

# Company cash flow statement

## for the year ended 31 December 2021

| | 2021 £ million | 2020 £ million |
|---|---|---|
| **Cash flows from operating activities** | | |
| Profit/(loss) before taxation | **2.0** | (3.0) |
| Adjustments for: | | |
| Change in current liabilities | **(3.1)** | 5.6 |
| Change in current assets | **1.1** | (2.6) |
| **Net cash provided by operating activities** | **–** | – |
| **Cash flows from investing activities** | | |
| Increase in loans to subsidiaries | **(300.0)** | (450.0) |
| Decrease in loans to subsidiaries | **385.0** | |
| **Net cash used in investing activities** | **85.0** | (450.0) |
| **Cash flows from financing activities** | | |
| Issue of subordinated liabilities | **300.0** | – |
| Repayment of subordinated liabilities | **(385.0)** | – |
| Issue of senior unsecured debt securities | **–** | 450.0 |
| **Net cash provided by financing activities** | **(85.0)** | 450.0 |
| Change in cash and cash equivalents | **–** | – |
| Cash and cash equivalents at 1 January | **–** | – |
| **Cash and cash equivalents at 31 December** | **–** | – |

The accompanying notes are an integral part of the financial statements.

# Notes to the Company financial statements

## 1. Basis of preparation

The financial statements of TSB Banking Group plc (the Company), a public limited company, limited by shares, with registered office 20 Gresham Street, London, EC2V 7JE, have been prepared in accordance with UK adopted international accounting standards. The Company financial statements have been prepared under the historical cost convention as modified by the recognition of derivative financial instruments at fair value through profit or loss.

The accounting policies that are applicable to the Company are included in TSB's accounting policies and the following policy is also applicable.

**Investments in subsidiaries**
Investments in subsidiaries are initially recognised at cost and subsequently held at cost less any impairment charge. An impairment charge is recognised when the carrying amount of the investment exceeds its recoverable amount.

## 2. Non-current liabilities

*Debt securities in issue – senior unsecured debt securities*

In December 2020, the Company issued £450.0 million floating rate notes due June 2023 to its parent company, Sabadell, at an issue price of 100% of the principal amount. The notes pay interest at SONIA plus 2.1% payable quarterly in arrears. The Company has the option to redeem these notes in June 2022 and quarterly thereafter, subject to approval of the PRA.

*Subordinated liabilities*

| | 2021 £ million | 2020 £ million |
|---|---|---|
| Fixed-to-floating rate callable subordinated Tier 2 capital notes, due March 2031 | **300.0** | – |
| Fixed-to-floating rate callable subordinated Tier 2 capital notes, due May 2026 | **–** | 385.0 |
| Accrued interest | **0.1** | 3.4 |
| Unamortised discount | **–** | (0.1) |
| **Total subordinated liabilities** | **300.1** | 388.3 |

In March 2021, the Company issued £300.0 million fixed-to-floating rate callable subordinated Tier 2 capital notes, due to mature in March 2031, to its parent company, Sabadell. These were issued at a price of 100% of the principal amount. The notes pay interest at a fixed rate of 3.449% per annum payable quarterly in arrears until March 2031 at which time the interest rate becomes SONIA plus 3.05% per annum payable quarterly in arrears. The Company has the option to redeem these notes in March 2026, subject to approval of the PRA.

In May 2021, the Company exercised its early call option over £385.0 million of fixed-to-floating rate callable subordinated Tier 2 capital notes. Prior to their redemption, the notes paid interest at a rate of 5.75% per annum, payable semi-annually in arrears.

## 3. Share capital, share premium and merger reserve

Details of the Company's share capital, share premium and merger reserve are set out in note 22 to the consolidated financial statements.

## 4. Related party transactions

The Company enters into transactions with related parties in the normal course of its business. The sections below detail, on an aggregated basis, related party transactions, balances outstanding at the year end and related income.

**(i) Key management personnel**
The key management personnel of the Company are the same as those of TSB Bank plc. The relevant disclosures are set out in note 24 to the consolidated financial statements.

# Notes to the Company financial statements

## 4. Related party transactions (continued)

**(ii) Investment in subsidiaries**

The Company's only legal subsidiary undertaking is TSB Bank plc, a banking business incorporated and registered in Scotland whose registered office is Henry Duncan House, 120 George Street, Edinburgh, EH2 4LH.

The Company holds 100% of the ordinary share capital and voting rights of TSB Bank plc and carried this investment at its cost of £1,589.4 million (2020: £1,589.4 million).

**Significant estimate – impairment assessment**

In the light of the ongoing economic uncertainty an impairment assessment was undertaken. This concluded that no impairment was required as the recoverable amount of the Company's investment exceeded its £1,589.4 million carrying amount.

In estimating the recoverable amount of the Company's investment, TSB Bank plc's value in use was calculated using a discounted cash flow approach. This method consisted of estimating the theoretical dividends that could be distributed in the future after equity requirements were met.

Significant judgement was required in estimating the key inputs to the valuation model, which comprised the forecast post tax profits of TSB Bank plc and the discount rate to be applied. Forecast profits were based on the Board's approved medium term plan, covering the period to 2026. Profits in the subsequent period were estimated to increase at nominal rate of 1.7% (2020: 1.7%). A post tax rate of 9.0% (2020: 9.1%) was used to discount the estimated future cash flows.

The value in use is sensitive to alternative inputs. A 1% increase in the discount rate to 10.0% would decrease the value in use by £242 million. A decrease in the long term forecast profit growth rate from 1.7% to zero would decrease the value in use by £126 million. Under each of these alternative inputs, the value in use would continue to exceed the carrying value. If the long term forecast profit growth rate was reduced to zero, the discount rate would have to increase by 3.6% to 12.6% to eliminate the headroom in the recoverable amount. As such, it was concluded that that no impairment was required.

In addition, TSB Banking Group plc Employee Share Trust is accounted for as a subsidiary of the Company and the registered office of this entity is 26 New Street, St Helier, Jersey, JE 3RA.

The following entities are accounted for as subsidiary companies of TSB Bank plc as it exercises control of each entity under IFRS 10 *Consolidated Financial Statements.* The registered office of each of these entities is 35 Great St Helen's, London, EC3A 6AP*:*

- TSB Covered Bonds LLP;
- TSB Covered Bonds (LM) Limited; and
- TSB Covered Bonds (Holdings) Limited.

**(iii) Loans to subsidiaries**

| | 2021<br>£ million | 2020<br>£ million |
|---|---|---|
| Loans to subsidiaries | **750.0** | 835.0 |
| Unamortised discount | **–** | (0.1) |
| Accrued interest | **0.2** | 3.5 |
| **Total loans to subsidiaries** | **750.2** | 838.4 |

In December 2020, the Company subscribed for £450 million of floating rate notes due June 2023 issued by its principal subsidiary, TSB Bank plc.

In March 2021, the Company subscribed for £300.0 million fixed-to-floating rate callable subordinated Tier 2 capital notes, due to mature in March 2031, issued by TSB Bank plc.

In May 2021, TSB Bank plc exercised its early call option over £385.0 million of fixed-to-floating rate callable subordinated Tier 2 capital notes that the Company had subscribed for in 2014.

The allowance for credit impairment losses on these IFRS 9 stage 1 loans was nil (2020: nil).

# Notes to the Company financial statements

### 4. Related party transactions (continued)

**(iv) Other related party transactions**

At 31 December 2021, amounts due by the Company to subsidiary companies were £17.4 million (2020: £18.5 million). Amounts due from subsidiary companies were £1.5 million (2020: £0.4 million).

The Company holds forward purchase agreements with Sabadell to acquire 8.5 million (2020: 10.5 million) Sabadell shares to satisfy estimated requirements under various share based compensation arrangements. This forward agreement had an asset fair value of £0.9 million (2020: liability fair value of £2.7 million) and TSB Banking Group plc had received cash collateral from Sabadell of £0.7 million (2020: placed cash collateral of £2.7 million).

### 5. Financial instruments

**(i) Measurement basis of financial instruments**

The following table analyses the carrying amounts of the Company's financial instruments:

| At 31 December 2021 | At fair value through profit or loss £ million | Financial assets at amortised cost £ million | Held at amortised cost £ million | Total £ million |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Loans to subsidiaries | **–** | **750.2** | **–** | **750.2** |
| Derivative financial assets | **0.9** | **–** | **–** | **0.9** |
| **Total financial assets** | **0.9** | **750.2** | **–** | **751.1** |
| **Financial liabilities** | | | | |
| Debt securities in issue | **–** | **–** | **(450.1)** | **(450.1)** |
| Subordinated liabilities | **–** | **–** | **(300.1)** | **(300.1)** |
| **Total financial liabilities** | **–** | **–** | **(750.2)** | **(750.2)** |
| **At 31 December 2020** | | | | |
| **Financial assets** | | | | |
| Loans to subsidiaries | – | 838.4 | – | 838.4 |
| **Total financial assets** | – | 838.4 | – | 838.4 |
| **Financial liabilities** | | | | |
| Derivative financial liabilities | (2.7) | – | – | (2.7) |
| Debt securities in issue[(1)] | – | – | (450.1) | (450.1) |
| Subordinated liabilities | – | – | (388.3) | (388.3) |
| **Total financial liabilities** | (2.7) | – | (838.4) | (841.1) |

(1) Comparative information has been reclassified to align with the current year presentation.

**(ii) Fair value of financial instruments**

The table below analyses the fair values, and valuation hierarchy, of the financial assets and liabilities of the Company. The valuation techniques for the Company's financial assets and liabilities are set out in notes 5 and 10 to the consolidated financial statements.

| At 31 December 2021 | Level 1 £ million | Level 2 £ million | Level 3 £ million | Total fair value £ million | Total carrying value £ million |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Loans to subsidiaries | **–** | **751.7** | **–** | **751.1** | **750.2** |
| Derivative financial assets | **–** | **0.9** | **–** | **0.9** | **0.9** |
| **Financial liabilities** | | | | | |
| Debt securities in issue | **–** | **(451.9)** | **–** | **(451.9)** | **(450.1)** |
| Subordinated liabilities | **–** | **(299.8)** | **–** | **(299.8)** | **(300.1)** |
| **At 31 December 2020** | | | | | |
| **Financial assets** | | | | | |
| Loans to subsidiaries | – | 844.1 | – | 844.1 | 838.4 |
| **Financial liabilities** | | | | | |
| Derivative financial liabilities | – | (2.7) | – | (2.7) | (2.7) |
| Debt securities in issue | – | (450.1) | – | (450.1) | (450.1) |
| Subordinated liabilities | – | (390.4) | – | (390.4) | (388.3) |

# Notes to the Company financial statements

## 5. Financial instruments (continued)

### (iii) Credit risk

Credit risk arises from amounts due from its wholly owned subsidiary, TSB Bank plc. At 31 December 2021, no allowance for expected credit losses was required (2020: £nil).

### (iv) Liquidity risk

The table below analyses the financial liabilities of the Company by relevant contractual maturity grouping on an undiscounted future cash flow basis based on the remaining period at the balance sheet date.

| At 31 December 2021 | Up to 1 month £ million | 1-3 months £ million | 3-12 months £ million | 1-5 years £ million | Over 5 years £ million | Total £ million |
|---|---|---|---|---|---|---|
| Debt securities in issue | **–** | **2.4** | **7.3** | **454.9** | **–** | **464.6** |
| Subordinated liabilities | **–** | **2.6** | **7.8** | **333.6** | **–** | **344.0** |
| **Total non-derivative financial liabilities** | **–** | **5.0** | **15.1** | **788.5** | **–** | **808.6** |
| **At 31 December 2020** | | | | | | |
| Debt securities in issue | – | – | – | 504.0 | – | 504.0 |
| Subordinated liabilities | – | – | 396.1 | – | – | 396.1 |
| **Total non-derivative financial liabilities** | – | – | 396.1 | 504.0 | – | 900.1 |
| Derivative liabilities – outflows | – | – | 2.7 | – | – | 2.7 |
| **Total** | – | – | 398.8 | 504.0 | – | 902.8 |

# Independent auditor's report to the members of TSB Banking Group plc

**1 Our opinion is unmodified**
We have audited the financial statements of TSB Banking Group plc ("the Group") for the year ended 31 December 2021 which comprise the consolidated balance sheet, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated cash flow statement, Parent Company balance sheet, Parent Company statement of changes in equity, Parent Company cash flow statement, and the related notes, including the accounting policies.

In our opinion:
- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2021 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with UK-adopted international accounting standards;
- the parent Company financial statements have been properly prepared in accordance with UK-adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

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

We were first appointed as auditor by the shareholders on 5 May 2020. The period of total uninterrupted engagement is for the two financial years ended 31 December 2021. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

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

# Independent auditor's report to the members of TSB Banking Group plc (continued)

## 2 Key audit matters: our assessment of risks of material misstatement (continued)

| | The risk | Our response |
|---|---|---|
| ***Expected credit losses on loans and advances to customers***<br><br>**Risk vs 2020: ◄►**<br><br>***31 December 2021: £189.6 million***<br><br>***(31 December 2020: £239.0 million)***<br><br>***Refer to page 45 (Audit Committee report) and note 8 (accounting policy and financial disclosures)*** | ***Subjective estimate***<br>The measurement of expected credit losses ('ECL') on loans and advances to customers involves significant judgements and estimates. A heightened risk of material misstatement of ECL continues to arise in the current year due to the increased judgement and estimation uncertainty as a result of COVID-19.<br><br>The key areas where we identified greater levels of judgement and therefore increased levels of audit focus in the Group's estimation of ECL are:<br><br>• **Economic scenarios** – IFRS 9 requires the Group to measure ECL on a forward-looking basis reflecting a range of future economic conditions. Significant judgement is applied in determining the economic scenarios used, particularly in the context of COVID-19, and the probability weightings assigned to each economic scenario.<br><br>• **Qualitative adjustments** – Adjustments to the model-driven ECL results are raised by the Group to address issues relating to model limitations, model responsiveness or emerging trends including those relating to COVID-19. Certain adjustments are inherently uncertain and significant judgement is involved in estimating these amounts.<br><br>• **Significant Increase in Credit Risk ('SICR')** – The criteria selected to identify a significant increase in credit risk is a key area of judgement within the Group's ECL calculation as these criteria determine whether a 12 month or lifetime provision is recorded.<br><br>• **Model estimations** – Inherently judgmental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD'). The LGD model used in the secured portfolio and the PD models used in the unsecured portfolios are the key drivers of the Group's ECL results and are therefore the most significant judgmental aspects of the Group's ECL modelling approach.<br><br>The effect of these matters is that, as part of our risk assessment, we determined that the ECL on loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the Group (note 8).<br><br>**Disclosure quality**<br>The disclosures regarding the Group's application of IFRS 9 are key to explaining the key judgements and material inputs to the IFRS 9 ECL results. | Our audit procedures included:<br><br>**Test of details:** We recalculated the ECL measured on each of TSB's loan portfolios. We performed sample testing over key inputs, data and assumptions impacting ECL calculations to assess the reasonableness of economic forecasts, weights, and model assumptions applied.<br><br>**Our economic scenario expertise:** We involved our own economic specialists to assist us in assessing the appropriateness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them. We assessed the overall reasonableness of the economic forecasts by comparing the Group's forecasts to our own modelled forecasts. As part of this work we challenged the reasonableness of the Group's considerations of the economic uncertainty relating to COVID-19.<br><br>**Qualitative adjustments:** For each of the significant adjustments to the model-driven ECL results we assessed the reasonableness of the adjustments by evaluating the key assumptions, inspecting the calculation methodology, tracing a sample of data used back to source data, and recalculating the qualitative adjustments.<br><br>**SICR**: We assessed the ongoing effectiveness of the SICR criteria and independently calculated the loans' stage for TSB's loans and advances.<br><br>**Our financial risk modelling expertise:** We involved our own financial risk modelling specialists in evaluating the Group's IFRS 9 models. We used our knowledge of the Group and our experience of the industry that the Group operates in to independently challenge the appropriateness of the Group's IFRS 9 models.<br><br>**Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's overall ECL. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear.<br><br>**Our results**<br>The results of our testing were satisfactory, and we considered the ECL charge and provision recognised and the related disclosures to be acceptable (2020: acceptable). |

# Independent auditor's report to the members of TSB Banking Group plc (continued)

**2 Key audit matters: our assessment of risks of material misstatement (continued)**

| | The risk | Our response |
|---|---|---|
| ***IT access, change management and operations***<br><br>**Risk vs 2020: ◄►**<br><br>***Refer to page 47 (Audit Committee report)*** | ***Data capture and integrity***<br>The Group has self-acknowledged historical issues with the design and implementation of controls within the Group's IT control environment, specifically in relation to user access and change management.<br><br>During 2021 the Group has continued to work on improving the IT control environment.<br><br>The Group's accounting and reporting processes are dependent on automated controls (such as data feeds or automated calculations) enabled by IT systems. These are then supported by general IT controls ('GITCs') covering areas such as access and change management and batch processing, which ensure the integrity of the Group's IT systems.<br><br>There is a risk that, if the GITCs are not effective, then inappropriate access could be gained to IT applications and inappropriate changes made to the application itself or to the integrity of related automated controls.<br><br>In addition, GITCs that are not effective could also affect the integrity of data stored on the IT systems and the effectiveness of automated and manual controls that use this data. | **Our procedures included:**<br><br>**Risk assessment:** We performed a risk assessment of the Bank's general IT control environment and the status of the Group's IT remediation programme to assess their impact on our audit approach.<br><br>**Control testing:** We tested the design, implementation and operating effectiveness of relevant controls over granting, removal and modification of access rights, including privileged access rights, change management and batch processing. For a sample of changes, we assessed that each change was appropriately tested, approved and appropriate segregation of duties was in place.<br><br>**Test of details**: We assessed the appropriateness of the privileged access rights granted to applications and databases relevant to financial accounting and reporting systems and investigated identified exceptions. For relevant batch jobs, we assessed that resolutions were appropriately identified and resolved.<br><br>**Extended scope:** As a result of the above, we extended our audit testing to address deficiencies identified, including:<br><br>• Where, despite not being able to rely on the associated general IT controls, we decided to continue to place reliance on selected automated controls, including those which support the allocation of payments, we increased the frequency with which we manually tested the operation of these automated controls during the period subject to audit. This approach allowed us to assess whether the deficiencies identified had impacted the operation of the specific automated control we wanted to rely on.<br><br>• We identified and placed reliance on selected manual controls where appropriately designed to mitigate the same process risk as the relevant automated control.<br><br>• We performed incremental substantive procedures to mitigate the same process risk as the relevant automated control. Procedures included:<br><br>○ Sample testing to agree relevant data elements used in the financial reporting process, including customer and transactional data, to appropriate supporting evidence. As we did not place reliance on certain GITCs, we increased our sample sizes for this testing; and<br><br>○ Where we performed substantive testing over areas such as data calculations, we increased our sample sizes because we did not place reliance on relevant GITCs. |

# Independent auditor's report to the members of TSB Banking Group plc (continued)

**2 Key audit matters: our assessment of risks of material misstatement (continued)**

| | The risk | Our response |
|---|---|---|
| ***IT access, change management and operations (continued)*** | | **Our results:** We aligned our testing of GITCs to the Group's IT remediation project during the year and identified certain automated controls that we could rely on in our audit. This was either because GITCs were effective or we were able to satisfy ourselves, through the additional work described above, that the deficiencies identified had not impacted the specific automated control. As a result of our testing of the general IT control environment and through the performance of the above incremental, mitigating procedures, we have therefore been able to reduce the audit risk relating to IT access, change management and operations to an acceptable level. (2020: We did not test GITCs).<br><br>With regard to automated controls, we did not identify any significant deficiencies or any material errors in the relevant data elements that we tested (2020: We did not identify any significant deficiencies in the automated controls or any material errors in the relevant data elements which we tested). |
| ***Recoverability of investment in subsidiary (Parent Company only)***<br><br>**Risk vs 2020: ◄►**<br><br>***31 December 2021: £1,589 million***<br>***31 December 2020: £1,589 million***<br><br>***Refer to page 46 (Audit Committee Report) and note 4(ii) on page 116 (accounting policy and financial disclosures).*** | ***Recoverability of investment***<br>The carrying amount of the Parent Company's investment in subsidiary is significant. The estimated recoverable amount of this balance is subjective due to the inherent uncertainty in forecasting future trading conditions and cashflows.<br><br>The effect of these matters is such that, as part of our risk assessment, we determined that the recoverable amount of the cost of investment in subsidiary has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole. The financial statements (note 4(ii) on page 116) disclose the sensitivity estimated by the Parent Company. | Our procedures included:<br><br>***Methodology assessment:*** We assessed whether the value in use methodology was an appropriate valuation methodology and in line with the requirements of IAS36.<br><br>***Benchmarking assumptions***: We compared the growth rate assumption and discount rate applied to externally derived data for these key inputs.<br><br>***Our expertise***: We assessed the appropriateness of the discount rate. We independently calculated discount rate ranges using external data sources and peer bank data for risk-free rates, betas and market/entity risk premiums.<br><br>***Sensitivity analysis*:** We performed breakeven analysis on the discount rate and terminal growth rate.<br><br>***Reliability of forecasts:*** We challenged the reasonableness of key judgements and assumptions in estimating the forecasts.<br><br>***Historical comparison:*** We assessed the Directors' ability accurately to prepare forecasts by comparing historical forecasts to actual results.<br><br>***Comparing valuations:*** We assessed the consistency of projected cash flows per the impairment assessment to the Board approved forecasts.<br><br>***Assessing transparency***: We assessed whether the Parent Company's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of the investment in subsidiary.<br><br>**Our results**<br>We found the Parent Company's conclusion that there is no impairment of its investment in subsidiaries to be acceptable (2020: acceptable). |

# Independent auditor's report to the members of TSB Banking Group plc (continued)

**2 Key audit matters: our assessment of risks of material misstatement (continued)**

We continue to consider the impact of macroeconomic uncertainty on our audit. The financial statements explain how the Directors have incorporated the impact of macroeconomic uncertainty in their determination of ECL provisions and the carrying value of the Parent Company's investment in subsidiary. Our response to both these matters is set out in more detail in the Key Audit Matters above. The financial statements also explain how the Directors have formed a judgement that it is appropriate to adopt the going concern basis of preparation for the Group and Parent Company. This judgement takes into account all relevant aspects including the impact of the macroeconomic environment. However, following the more favourable COVID-19 macroeconomic outlook as at 31 December 2021, we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

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

Materiality for the financial statements as a whole was set at £10.0 million (2020: £7.5 million), determined with reference to a benchmark of total revenue, of which it represents 1.02% (2020: 0.81%).

Materiality for the Parent Company financial statements as a whole was set at £10.0 million (2020: £7.5 million), determined with reference to a benchmark of Parent Company total assets and limited so as to not exceed group materiality. It represents 0.43% of Parent Company total assets (2020: 0.3%).

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

Performance materiality for the Group and Parent Company was set at 65% (2020: 65%) of materiality for the financial statements as a whole, which equates to £6.5 million (2020: £4.88 million). Last year's performance materiality reflected the fact that it was our first year as auditors and we did not test general IT controls. The performance materiality percentage remains unchanged from last year on the basis that this is the first year we planned to test general IT controls.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.5 million (2020: £0.375 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

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

The Group team performed the audit of the Group as if it was a single aggregated set of financial information. The audit was performed using the materiality and performance materiality levels set out above.

**4 Going concern**

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

We used our knowledge of the Group, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Group's and Parent Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and Parent Company's available financial resources over this period were:

- the availability of funding and liquidity in the event of a market wide stress scenario including the impact in which the global COVID-19 pandemic continues to unfold; and
- the impact on regulatory capital requirements in the event of an economic slowdown or recession.

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

We considered whether the going concern disclosure in the financial statements gives a full and accurate description of the Directors' assessment of going concern.

# Independent auditor's report to the members of TSB Banking Group plc (continued)

**4 Going concern (continued)**

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate;
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Group's or Parent Company's ability to continue as a going concern for the going concern period; and
- we found the going concern disclosure on page 61 (basis of preparation) to be acceptable.

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

**5 Fraud and breaches of laws and regulations – ability to detect**

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

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

- Enquiring of directors, Internal Audit and inspection of policy documentation as to the Group and Parent Company's high-level policies and procedures to prevent and detect fraud, including the Internal Audit function, and the Group and Parent Company's channel for 'whistleblowing', as well as whether they have knowledge of any actual, suspected or alleged fraud;
- Reading Board, Board Audit Committee and Risk Committee minutes;
- Considering remuneration incentive schemes and performance targets for management and directors;
- Using analytical procedures to identify any unusual or unexpected relationships; and
- Consultation with our own forensic professional regarding the identified fraud risks and the design of the audit procedures planned in response to these.

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

As required by auditing standards, and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, in particular the risk that Group management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements such as ECL on loans and advances to customers. On this audit we do not believe there is a fraud risk related to revenue recognition because there is limited complexity in the calculation and recognition of revenue.

We identified a fraud risk related to estimation of expected credit losses, specifically relating to economic scenarios and qualitative adjustments in response to significant estimation that involves subjective judgments or uncertainties that are difficult to corroborate. Further detail in respect of ECL is set out in the key audit matter disclosures in section 2 of this report.

We also performed procedures including:

- Identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included those posted by senior finance management and those posted and approved by the same user; and
- Assessing significant accounting estimates for bias.

We discussed with the Audit Committee matters related to actual or suspected fraud, for which disclosure is not necessary, and considered any implications for our audit.

# Independent auditor's report to the members of TSB Banking Group plc (continued)

**5 Fraud and breaches of laws and regulations – ability to detect (continued)**

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

As the Group is regulated, our assessment of risks involved gaining an understanding of the control environment including the entity's procedures for complying with regulatory requirements.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the Group's and Parent Company's license to operate. We identified the following areas as those most likely to have such an effect: specific areas of regulatory capital and liquidity, conduct, money laundering and financial crime and certain aspects of company legislation recognising the financial and regulated nature of the Group's and Parent Company's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to inquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

For the customer redress matter discussed in note 29, our procedures included inquiries of internal counsel and inspection of correspondence with the regulator.

For the joint regulatory investigation matter discussed in note 23, our procedures included inquiries with internal and external legal counsel as to the status of the investigation.

We discussed with the Audit Committee matters related to actual or suspected breaches of laws or regulations, for which disclosure is not necessary, and considered any implications for our audit.

*Context of the ability of the audit to detect fraud or breaches of law or regulation*
Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

# Independent auditor's report to the members of TSB Banking Group plc (continued)

**6 We have nothing to report on the other information in the Annual Report**
The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

***Strategic report and directors' report***
Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

**7 We have nothing to report on the other matters on which we are required to report by exception**
Under the Companies Act 2006, we are required to report to you if, in our opinion:

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

We have nothing to report in these respects.

**8 Respective responsibilities**

***Directors' responsibilities***
As explained more fully in their statement set out on page 51, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; 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; assessing the Group and Parent 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 they either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

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

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

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

**Pamela McIntyre (Senior Statutory Auditor)**
**for and on behalf of KPMG LLP, Statutory Auditor**
*Chartered Accountants*
15 Canada Square
London
E14 5GL
27 January 2022

# Glossary

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|---|---|
| **Allowance for credit impairment losses** | Provisions held on the balance sheet as a result of raising a charge against profit for expected credit losses in the loan book. The allowance may be either individual or collective. |
| **Arrears** | A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan is unpaid or overdue. Such a customer is also said to be in a state of delinquency and the entire outstanding balance is delinquent. |
| **Basel III** | The capital reforms and introduction of a global liquidity standard proposed by the Basel Committee on Banking Supervision in 2010 and due to be phased in, through CRD IV, from 1 January 2015 onward. This was further enhanced in December 2017 to refine the capital framework and introduce new elements including the output capital floor. These revisions will come into force between 1 January 2022 and 1 January 2027. |
| **Basis point (bps)** | One hundredth of a per cent (0.01 per cent). 100 basis points is 1 per cent. Used in quoting movements in interest rates. |
| **BCBS 239** | The Basel Committees standard entitled 'Principles for effective risk data aggregation and risk reporting'. |
| **Common Equity Tier 1 (CET1) capital** | The highest quality form of regulatory capital under CRD IV that comprises common shares issued and related share premium, retained earnings and other reserves less specified regulatory adjustments. |
| **Common Equity Tier 1 capital ratio** | Common Equity Tier 1 capital as a percentage of risk-weighted assets. |
| **Contractual maturities** | Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid. |
| **Coverage ratio** | Impairment allowance as a percentage of impaired loans. |
| **Customer deposits** | Money deposited by account holders. Such funds are recorded as liabilities of TSB. |
| **Encumbrance** | The use of assets to secure liabilities, such as by way of a lien or charge. |
| **Exposure at default** | Exposure at default (EAD) represents the estimated exposure to a customer in the event of default. In determining EAD amounts, consideration is made of the extent to which undrawn commitments may be drawn down at the point of default and the application of credit risk mitigation (i.e. eligible financial collateral). |
| **Forbearance** | Forbearance takes place when a concession is made on the contractual terms of a loan in response to an obligor's financial difficulties. |
| **Internal Capital Adequacy Assessment Process (ICAAP)** | TSB's own assessment of the amount and type of capital it considers adequate to cover the level and nature of the risks to which it is or might be exposed. |
| **Internal Liquidity Adequacy Assessment Process (ILAAP)** | TSB's own assessment of the adequacy of its liquidity and funding resources to cover the level and nature of risks to which it is or might be exposed. |
| **Internal Ratings-Based approach (IRB)** | A methodology of estimating the credit risk within a portfolio by utilising internal risk parameters to calculate credit risk regulatory capital requirements. There are two approaches to IRB: Foundation IRB and Advanced IRB. |
| **Leverage ratio** | Tier 1 capital divided by the exposure measure. Basel III reforms introduced a leverage ratio framework designed to reinforce risk based capital requirements with a simple, transparent, non-risk based 'backstop' measure. |
| **Liquidity Coverage Ratio (LCR)** | Measures the percentage of high quality liquid assets relative to expected net cash outflows over a 30 day period. High quality liquid assets should be unencumbered, liquid in markets during a time of stress and, ideally, be central bank eligible. |
| **Loan to deposit ratio** | The ratio of loans and advances to customers net of allowance for impairment losses divided by customer deposits. |

# Glossary (continued)

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| **Loans past due** | Loans are past due when a counterparty has failed to make a payment when contractually due. |
| **Loan-to-value ratio (LTV)** | The LTV ratio is a mathematical calculation which expresses the amount of a mortgage balance outstanding as a percentage of the total appraised value of the property. A high LTV indicates that there is less value to protect the lender against house price falls or increases in the loan if repayments are not made and interest is added to the outstanding balance of the loan. |
| **Loss given default** | Loss given default (LGD) represents the estimated proportion of an EAD amount that will be lost in the event of default. It is calculated after taking account of credit risk mitigation and includes the cost of recovery. |
| **Master netting agreement** | An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract. |
| **Migration** | In April 2018, TSB completed its phased migration onto a new IT platform built by Sabis, a subsidiary of TSB's parent company, Sabadell. The new IT platform covers all customer systems and channels as well as all back office systems. |
| **Net interest income** | The difference between revenues earned by interest-earning assets and the cost of interest-bearing liabilities. |
| **Net interest margin** | Net interest margin is net interest income as a percentage of average interest-earning assets. |
| **Net Promoter Score (NPS)** | NPS is based on the question "On a scale of 0-10, where 0 is not at all likely and 10 is extremely likely, how likely is it that you would recommend TSB to a friend or colleague?" NPS is the percentage of TSB customers who score 9-10 after subtracting the percentage who score 0-6. |
| **Pillar 3** | The third pillar of the Basel III framework aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market. |
| **Probability of default** | Probability of default (PD) represents an estimate of the likelihood that a customer will default on their obligation within a 12 month time horizon. |
| **Repurchase agreements** | Short-term funding agreements which allow a borrower to sell a financial asset as collateral for cash. As part of the agreement the borrower agrees to repurchase the security at some later date, usually less than 30 days, repaying the proceeds of the loan. |
| **Risk-weighted assets** | A measure of a bank's assets adjusted for their associated risks. Risk weightings are established in accordance with the Basel Capital Accord as implemented by the PRA. |
| **Sabadell** | Banco de Sabadell, S.A. This is TSB Banking Group plc's parent company. |
| **Securitisation** | Securitisation is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities. |
| **Standardised approach** | The Standardised approach to calculating credit risk capital requirements requires the use of a standard set of risk weights prescribed by the regulator. Use may be made of external credit ratings supplied by external credit assessment institutions to assign risk weights to exposures. Standardised approaches, following prescribed methodologies, also exist for calculating market risk and operational risk capital requirements. |
| **Subordinated liabilities** | Liabilities which, in the event of insolvency or liquidation of the issuer, are subordinated to the claims of depositors and other creditors of the issuer. |
| **Tier 1 capital** | A measure of a bank's financial strength defined by CRD IV. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, subject to deductions. |
| **Tier 1 capital ratio** | Tier 1 capital as a percentage of risk-weighted assets. |
| **Tier 2 capital** | A component of regulatory capital defined by CRD IV, mainly comprising qualifying subordinated loan capital and eligible collective impairment allowances. |
| **Whistletree** | A separate portfolio of former Northern Rock mortgages and unsecured loans which was acquired by TSB in 2015. |

# Abbreviations

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| **BPS** | Basis points |
| **CET1** | Common Equity Tier 1 |
| **CRD IV** | Capital Requirements Directive IV |
| **EDTF** | Enhanced Disclosure Task Force |
| **ECL** | Expected credit loss |
| **EIR** | Effective interest rate |
| **FCA** | Financial Conduct Authority |
| **GDPR** | General Data Protection Regulation |
| **HMRC** | Her Majesty's Revenue and Customs |
| **IAS** | International Accounting Standards |
| **ICAAP** | Internal Capital Adequacy Assessment Process |
| **IFRS** | International Financial Reporting Standards |
| **ILAAP** | Internal Liquidity Adequacy Assessment Process |
| **IRB** | Internal ratings based approach |
| **LBG** | Lloyds Banking Group |
| **LCR** | Liquidity coverage ratio |
| **LTV** | Loan to value |
| **MREL** | Minimum Requirement for Eligible Liabilities |
| **MSA** | Migration Services Agreement |
| **NPS** | Net promoter score |
| **OSA** | Outsourced Services Agreement |
| **PCA** | Personal current account |
| **POCI** | Purchased or originated credit impaired |
| **PRA** | Prudential Regulatory Authority |
| **SME** | Small and medium sized businesses |

# Contacts

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