ANNUAL REPORT & ACCOUNTS

2022

Manchester
BUILDING SOCIETY

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CHAIRMAN'S STATEMENT

The year saw an end to the low base rate environment which had been in place in the UK since 2009. The increase in the Bank of England base rate from 0.10% to 0.25% in December 2021 was followed by a further eight increases with the rate standing at 3.50% by the end of the year. Whilst this allowed the Society to increase its net interest margin slightly, the impact was less beneficial to the Group than to many of our competitors owing to the proportion of our loan portfolio with a fixed interest rate.

We remain conscious of the financial strain on our members from increasing interest rates on mortgages, particularly at a time of high inflation affecting essentials such as food, heating and fuel. We continue to work closely with customers and members who are struggling to make payments on their loans.

In the year, net interest income fell from £6.2m to £5.8m with mortgage balances and savings balances each falling by 14% as part of the Society's managed decline of the balance sheet. Administrative expenses, excluding legal costs recovered, increased by £0.6m. Other operating income of £0.9m (2021: net charge of £0.8m) mainly relates to foreign exchange gains which are partially offset by £0.6m of foreign exchange losses included within the impairment charge. Impairment totalled £2.5m (2021: £1.3m), of which £2.1m (2021: £1.4m) related to the Society's Spanish lifetime book. The worsening economic environment, and in particular the expected impact upon the housing market, has led to the additional provision requirements in 2022.

The Society received £2.4m in the year as a final settlement regarding costs paid during the legal dispute upon which the Supreme Court gave judgment in 2021. Since the judgment was announced, the Society has received a total of £24.2m in damages, costs and interest.

The underlying operating result, (that is, after impairment but before including legal costs recovered) was a loss of £1.3m compared with an underlying loss of £1.0m in the preceding twelve months. After taking account of the legal costs recovered, operating profit totalled £1.1m (2021: £20.8m). Profit after tax amounted to £1.1m (2021: £19.4m).

The Society's 6.75% Permanent Interest Bearing Shares ("PIBS") are classified as equity and as such the cost of financing those PIBS is taken through reserves rather than being shown within the Statement of Comprehensive Income. The charge for the year was £0.7m (2021: £0.3m)

At 31 December 2022, the Group reported retained earnings of £8.5m (2021: £8.1m).

The Society met all of its regulatory capital requirements in the year and made all PIBS coupon payments. Given the continuing decline in the scale of the Society's operations, possible changes in regulatory capital requirements and the risk of external economic stress events, there remains uncertainty over the Society's ability to make PIBS coupon payments in the longer-term.

As we publish our Annual Report and Accounts for 2022, the Society is in advanced talks with Newcastle Building Society regarding a merger of the Societies. Heads of Terms were signed in February 2023, and my Board colleagues and I expect the merger to be concluded later this year.

Previous Annual Reports have drawn attention to the long-term uncertainty surrounding the future of the Society. The Board believes that while the Group's current capital and liquidity position is regulatory-compliant the Group lacks the scale and resilience to endure a major financial or economic stress without raising additional capital. The Board's current projection is that, as a standalone entity, the Society would have recurring losses which will deplete capital reserves each year. Accordingly, the Board has considered a range of strategic options and concluded that the best interests of members would be served by a merger with a larger, stronger building society. In order to complete the merger in a considered and timely manner, given the limited alternative options open to the Society, the Board has requested that the Prudential Regulation Authority ("PRA") direct the merger under section 42B(3)(b) of the Building Societies Act 1986. The PRA have given their consent. The merger can, therefore, proceed via a resolution of the Board and would not require a members' vote.

The opportunities provided to our members and staff by a merger with Newcastle are compelling and the Board remain unanimous in their view that this provides the best possible outcome for our members. It is expected that all eligible members will be sent a Merger Notification Statement with further details of the merger around the end of March 2023.

D.A. Harding
Chairman
28 February 2023

STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2022

Introduction

The directors present their 100th Annual Report together with the financial statements and Annual Business Statement for the Group for the year ended 31 December 2022.

The Group consists of the Society and its wholly owned subsidiary: MBS (Mortgages) Limited.

The Group's strategy and results for the year are covered in detail in the sections that follow, along with the principal risks and uncertainties that the Group faces.

Strategy

The Society is owned by its members. The means by which its value is preserved is by providing products that meet the financial needs of both existing and potential members.

The Group's strategy since 2013 has been to reduce its risks and conserve its regulatory capital whilst considering longer term strategic options such as a safe sale of portfolios, certain assets or a merger. This strategy was necessary because of events, fully disclosed in the Annual Report and Accounts for the year ended 31 December 2012, that led to a material write-down of the Group's reserves following a change in the accounting treatment of certain financial assets.

Risk reduction has been achieved via the disposal of almost all of the Group's non-strategic UK lifetime mortgage assets. Further reduction has been sought by investigating the potential for disposals of other mortgage assets. The Board's strategic aim in this regard continues to be to move the Group's risk profile away from those legacy asset positions that carry higher risks and higher regulatory capital risk weightings where possible.

The Group has signed non-binding Heads of Terms with Newcastle Building Society with the objective of the two Societies merging during 2023. Until PRA approval is received and the merger is finalised, the Group will continue to manage down the balance sheet.

Regulatory capital conservation has continued to be a priority. The Group continues to have headroom above its Total Capital Requirements in total capital terms, and meets the qualitative standards for the level of CET 1 regulatory capital. The Society made the coupon payments due on both its issuances of PIBS throughout 2022, though, whilst the Society continues to manage down the size of the balance sheet, there remains some uncertainty over the Society's ability to make PIBS coupon payments in the long-term.

The uncertainties which exist regarding the longer term prospects of the Group are disclosed in Note 1 on page 26.

Business Model

The principal activities of the Group remain the provision of competitive facilities for personal savings and for servicing its existing mortgage finance book, which primarily supports owner occupation of residential property. The Group does not presently engage in further lending.

Key performance indicators

Key performance indicators ("KPIs") monitored by the Board include the following:

- Capital
- Liquid assets
- Retail balances
- Mortgages and other loans
- Administration expenses
- Profit on ordinary activities before tax

The KPIs are considered in more detail in the sections that follow below, with indications as to why each metric is considered to be of importance in assessing financial performance.

Review of business performance

The Group's underlying performance in 2022 has been impacted by continued economic uncertainty with inflation reaching levels not seen for forty years and projections of house price reductions in the coming years. At the same time, the Bank of England base rate of interest increased from 0.25% to 3.50% in the year. This has been reflected in increases to both interest receivable and interest payable.

In 2022 the Group reported a profit after tax for the financial year of £1.1m (2021: £19.4m).

In the year the Group reported operating profit before impairments and provisions of £3.6m (2021: £22.1m).

The £18.6m decrease in operating profit before impairments and provisions from 2021 is a result of:

- £19.4m lower damages, income and costs from the legal case that concluded in 2021.
- Net interest income in the year being £0.4m lower than in 2021 due to lower balances as the Society continued a managed reduction in the size of the balance sheet. The benefit the Society has received on interest income from the increased Bank base rate has been offset by additional payable to Savings customers. The interest payable includes £0.4m in relation to PIBS coupon payments (2021: £0.3m).
- Operating costs, excluding legal costs recovered, being £0.6m higher than in 2021 driven by £0.2m of additional staff costs and £0.2m of additional professional fees in relation to the proposed merger with Newcastle Building Society

Partially offset by:

- A £1.7m increase in other operating income and charges with foreign exchange gains of £0.9m in the year compared with exchange losses of £0.8m in 2021. These losses are largely offset within impairment as outlined below.

The Group recorded a credit impairment charge of £0.4m (2021: £0.2m release) relating to the UK portfolios and an other impairment charge of £2.1m (2021: £1.4m) relating to the Society's Spanish lifetime portfolio. The charge on the Spanish lifetime portfolio consisted of an underlying charge of £1.5m and foreign exchange losses of £0.6m (2021: £2.2m underlying charge and a £0.8m foreign exchange gain).

PROFITABILITY

Result for the year: The Group reported a post-tax profit for the financial year of £1.1m (2021: £19.4m). The movements, alongside the cost of financing the Equity PIBS, are shown in the Statement of Changes in Equity on page 23.

FINANCIAL POSITION

Liquid assets: The Group's liquid assets are deposited with the Bank of England and with UK clearing bank counterparties in instantly accessible bank accounts. Of the Group's total liquid funds at 31 December 2022, £38.2m was deposited with the Bank of England (2021: £37.7m) and £5.0m was deposited with UK clearing banks (2021: £10.6m). No investment securities were held at 31 December 2022 (2021: £nil).

Mortgages and other loans: Group mortgage balances, after provisions, were £132.0m (2021: £153.3m), representing a year on year decrease of 13.9% (2021: 14.8% decrease). To protect its regulatory capital position, the Society made no advances during the year (2021: £nil).

Overall, the performance of the core mortgage book continues to be in line with expectations. The Group has continued in its efforts to minimise mortgage arrears and to help borrowers in difficulties, taking a consultative approach with borrowers who experience payment difficulties and applying forbearance as appropriate. At 31 December 2022, excluding the second charge portfolio, there were 14 mortgage accounts (2021: 17) where payments were 12 or more months in arrears. Outstanding balances on these accounts amounted to £2.9m (2021: £5.4m) representing 2.2% of total gross mortgage balances (2021: 3.5%), with total arrears of £0.4m (2021: £0.8m). The percentage of accounts 12 months or more in arrears remained stable despite the declining level of total mortgage assets in the year and the absence of new lending. The underlying arrears performance has also remained stable.

There was 1 UK property in possession at the end of the year (2021: 4). These figures include the NMB MAC portfolio and The Consumer Loans Company Limited ('CLC') portfolio. As insufficient reliable data exists, arrears banding information is not presented for these second charge portfolios.

Provisions for potential mortgage losses have been calculated after considering expected future credit performance, probabilities of default, arrears and forbearance positions and historic loss experience. Mortgage accounts in arrears by 3 months or more are reviewed regularly, as are impairment provision requirements.

Further information is given in Note 1.

Non-current assets held for sale: One property is classified as held for sale at 31 December 2022 (2021: 2). This property is in Spain and was previously used as collateral within the Society's Spanish lifetime portfolio. The property is now owned by the Society and is expected to be sold within the next 12 months. The property is held at £0.3m which is the lower of fair value and carrying value.

Other assets: Included within Other assets is a sum of £1.3m (2021: £1.1m) relating to collateral deposited in the form of cash under credit support annex agreements ("CSA") with the Group's counterparty providers of foreign exchange swaps.

Retail balances: Retail balances reduced to £129.4m (2021: £150.3m) in line with the overall reduction in the balance sheet. The range of savings products available during the year was carefully managed in order to ensure that a suitable level of funding was held and that the rates offered were appropriately competitive.

Capital: The purpose of the Group's capital is to support its mortgage book and to absorb any losses that may arise, thereby offering members protection as a regulated deposit taker.

The Board aims to manage capital within the regulatory limits set by the PRA. For regulatory capital purposes the Group is made up of the Society and MBS (Mortgages) Limited, with the regulatory capital positions at 31 December 2022 and 31 December 2021 being:

	Group 31 Dec 21 £000	Movement in 2022 £000	Group 31 Dec 22 £000	Regulatory Movement effective from 1 Jan 2023 £000	Group 1 Jan 23 £000
Tier 1 Capital					
Accumulated profit	8,229	282	8,511	(75)	8,436
Profit Participating Deferred Shares	17,461	-	17,461	-	17,461
Total CET1 Capital	25,690	282	25,972	(75)	25,897
Permanent Interest Bearing Shares					
Nominal balance	14,788	-	14,788	-	14,788
Amortisation	(13,309)	(1,479)	(14,788)	-	(14,788)
Net Permanent Interest Bearing Shares	1,479	(1,479)	-	-	-
Total Tier 1 Capital	**27,169**	**(1,197)**	**25,972**	**(75)**	**25,897**
Tier 2 Capital					
Subordinated Debt					
Nominal balance	5,000	(5,000)	-	-	-
Amortisation	(4,500)	4,500	-	-	-
Net Subordinated Debt	500	(500)	-	-	-
Permanent Interest Bearing Shares	13,309	1,479	14,788	-	14,788
Total Tier 2 Capital	**13,809**	**979**	**14,788**	**-**	**14,788**
Total Regulatory Capital	**40,978**	**(218)**	**40,760**	**(75)**	**40,685**

Since the end of 2021 Total Regulatory Capital has decreased by £0.2m made up as follows:

- An increase to the retained profit of the regulatory capital group for the year of £0.3m which included £0.7m interest on PIBS as shown in the Statement of Changes in Equity on page 23, and a reduction to reserves in relation to the transitional arrangements of IFRS 9 – *Financial Instruments* as detailed below and a small adjustment in relation to amortisation of intangible fixed assets;
- a reduction of subordinated debt, consisting of the continued grandfathering of subordinated debt out of Tier 2 capital over a 9 year period, amounting to £0.5m in the year. The subordinated debt was subsequently redeemed in the year.

Under the rules applicable from 1 January 2022, Total Regulatory Capital is reduced by £75k compared to the position at 31 December 2022. The available IFRS 9 transitional arrangements, adopted by the Group in 2018, reduced Total Regulatory Capital by an additional £75k from 1 January 2022, thus completing the phased implementation of the impact of the introduction of IFRS 9.

The Group meets all of the quantitative and qualitative requirements regarding the level of regulatory capital it must hold. Prior to June 2021, the Group did not meet the qualitative standards for the level of CET 1 regulatory capital. The Group continues to follow a medium to long-term strategic plan, against which it is monitored by the PRA. The plan shows that the Society remains viable in the medium-term and the Society has significant headroom against this plan. Although largely mitigated by the profits generated in 2021, it is recognised that there are a number of long-term risks to this plan, particularly following a stress event in the economy or financial markets.

The Society made the coupon payments on both its issuances of PIBS in April 2022 and October 2022. This followed the return to such payments in October 2021 for the first time since April 2016 as, in order to conserve capital, such a distribution was previously prohibited under the applicable regulatory capital conservation rules. Whilst the Society continues to manage down the size of the balance sheet, there remains some uncertainty over the Society's ability to make PIBS coupon payments in the medium to long-term.

The implementation of Capital Reporting Directive V ("CRD V") and the related Capital Reporting Requirements II ("CRR II") have not had a significant impact on the Group's regulatory capital position.

As outlined on pages 6 and 27, the Group will adopt IFRS 9 – *Financial Instruments*, as allowable under IFRS 17 – *Insurance Contracts*, in 2023 when valuing its Spanish lifetime portfolio. The impact of the change in accounting methodology is expected to result in a reduction in CET 1 capital of between £3m and £5m. This reduction in CET 1 will not lead to the Group breaching any of its capital requirements.

Financial Risk Management Objectives

The Group offers savings products and services mortgage products. It undertakes limited interaction with the wholesale money market for cash flow and liquidity management purposes. There are formal structures in place to monitor, report and manage the risks associated with the Group's operations. The Board seeks to manage the risks that the Group faces through a suite of regularly reviewed and approved policies covering: Credit, Liquidity, Financial Risk Management and Operational Risk.

Principal Risks and Uncertainties

The Group are currently working towards a potential merger with Newcastle Building Society. If the merger is completed, all the Group's assets and liabilities will transfer to Newcastle Building Society and the Group will cease to exist. Heads of Terms have been exchanged between the Boards of Manchester and Newcastle and it is proposed that the merger will take place on 1 July 2023. The binding Instrument of Transfer has not yet been signed and regulatory approval is required.

The Group meets all quantitative and qualitative requirements for the level of regulatory capital to be held being met at 31 December 2022. Without a merger with another organisation, however, there remains uncertainty regarding the ability of the Society to maintain its regulatory capital compliance as the balance sheet continues to run-off.

During 2022, a combination of the effects of the Covid-19 pandemic, the exit of the United Kingdom (UK) from the European Union ("EU") in 2020 and the ongoing war in Ukraine has led to significant economic uncertainty, not only within the UK, but worldwide. The highest levels of inflation in the UK in forty years has also led to the Bank of England increasing interest base rates from 0.25% at the start of the year to 3.50% at the year end.

High levels of inflation affects the Group directly with an increasing cost base. In addition, the combination of increases in the base rate of interest and high levels of inflation impact upon the ability of borrowing customers to make the payments that are due on their mortgages.

Three years after the UK left the EU, the medium to long-term impact on UK government policy, the financial markets and the wider UK economy remains unclear. The Group's Spanish lifetime portfolio introduces additional uncertainty and risk which the Board is monitoring; in particular there is added risk and uncertainty in relation to foreign exchange volatility, property values for the Spanish lifetime portfolio and the behavioural impact on Spanish lifetime mortgage borrowers. The legal advice taken by the Group remains that operational risk in relation to the servicing of the loan book is limited.

Under *IFRS 9 – Financial instruments* impairment is based on expected credit losses ("ECL"). An ECL provision is required for default events in the next 12 months, whilst a lifetime ECL is required when a significant increase in credit risk is identified. The review of credit risk and the calculation of ECL are required to be unbiased and probability weighted, and should include all available relevant information, with assessments of current conditions and forecasts of future economic conditions. As a result the recognition and measurement of impairment is forward looking. Forecasts of economic conditions are uncertain and adverse movements in the forecasts create additional risks for the Group. As outlined below in "Insurance Risk", the Group's Spanish Lifetime portfolio will be accounted for under IFRS 9 from 1 January 2023. This increases the risks associated with this portfolio as it will be recognised at fair value with external factors having a significant impact upon that fair value. Any changes in fair value will be recognised within the Statement of Comprehensive Income.

At the end of 2021, the London Inter-Bank Offered Rate ("LIBOR") ceased to be considered as an appropriate rate for setting interest rates meaning that loans and savings accounts linked to LIBOR need to be transitioned to an alternative benchmark rate. In response, the Society redeemed its LIBOR linked subordinated debt and contacted affected mortgage customers to offer an alternative. A small number of mortgage customers have not yet accepted the proposed rate and will remain on "synthetic LIBOR" for a period in line with FCA guidelines.

Every business faces risks as part of its day-to-day operation. The Society has a low appetite for risk and the Board's risk management objectives are to minimise the risks that the Group faces by deploying a range of risk management policies and procedures within an appropriate control environment.

Summarised below are the Group's other key risks and uncertainties:

Credit Risk: The Group is exposed to the risk that it may not receive back in full any sum that has been loaned (in relation to loans and advances) or any sum that it has deposited with a banking counterparty (in relation to liquid assets) when such amounts fall due. The Board monitors credit risk, underlying security values and the level of impairment provisions on a regular basis. Credit risk is more of a consideration in relation to loans and advances to customers than in relation to the Group's liquid assets; the former involve relationships with individuals or small businesses, whilst the latter are far fewer in number, being restricted to either the Bank of England or UK High Street banks, where credit risk is assessed as being very low.

The Group's management of credit risk in respect of loans and advances recognises that as the portfolio runs off it is likely that a greater part of the residual assets will have a higher credit risk profile.

The assessment of credit risk and the related impairment provisioning is a critical accounting estimate, impacted by judgments relating to customer affordability and economic circumstances, including the level of interest rates. Prior to the current strategy of no new lending, credit risk was mitigated by appropriate mortgage underwriting and by limiting the Group's exposure to particular market sectors or loans exhibiting particular attributes. Since the cessation of new lending, credit risk has been mitigated through the monitoring of management information, assessment of arrears and forbearance cases, and regular loan provision reviews. The Society continues to work with customers to ensure that appropriate levels of forbearance are provided where necessary. The Group holds two mortgage books (the NMB MAC and CLC books), where previously it held a beneficial interest and these portfolios were administered by third parties. The Group assumed ownership of the CLC portfolio in 2015 and the NMB MAC portfolio in 2018. An assessment has been made of the estimated discounted future cash flows expected to arise from both these portfolios of loans which forms the basis for the impairment provision. Sensitivities in respect of the impairment provision required for these portfolios are given on page 38.

Insurance Risk: Impairment assessments incorporate the insurance risk attached to the Group's lifetime mortgage contracts, which are Euro-denominated. The risk arises from a contractual term within the relevant mortgage contracts which in certain circumstances precludes the Group from pursuing the borrower or the borrower's estate for any shortfall on redemption. This risk is managed through oversight of the portfolio, including monitoring valuations, the assessment of redemptions and provisioning policy. The insurance provision is a critical accounting estimate, as its assessment is based on expected future outcomes relating to the date on which an account redeems, expected to be on the death of the borrower, a move into care or through non-health related voluntary pre-payment. It is also affected by the assumptions made in relation to house price appreciation and depreciation. This means that the insurance risk provision can move by a material amount dependent upon these assumptions and market conditions. Details of the key sensitivities in relation to the insurance provision are given on page 50. Regular contact is maintained with customers to ensure that the properties are maintained and to understand any changes in circumstances which may lead to additional risk.

The Society currently accounts for its Spanish lifetime portfolio under IFRS 4 – *Insurance Contracts* which allows for the methodology of IAS 39 – *Financial Instruments* to be utilised. For accounting periods beginning on or after 1 January 2023, IFRS 4 will be replaced by IFRS 17 – *Insurance Contracts*. Allowable under the IFRS 17 rules is for a policy choice to adopt instead IFRS 9 – *Financial Instruments* if certain conditions are met. The Society will opt to adopt IFRS 9. This will result in the portfolio being measured at fair value through profit or loss ("FVPL") with movements in fair value being recognised in the income statement. This will lead to increased volatility of the income statement as the fair value calculation relies upon market wide borrowing costs which are outside the Society's control. The expected impact of applying this new accounting policy as of January 1 2023 is set out on page 4.

Liquidity Risk: The Group's strategy is to always maintain sufficient funds in unencumbered liquid form to ensure that its liabilities can be met as they fall due. Regular stress testing of liquidity is undertaken by separately using 20 week and 3 month time horizons. The Group operates within closely monitored Board-approved liquidity policy limits, which are reviewed on a daily basis by the Group's Finance and Treasury departments, reported to the Treasury Committee and considered by the Board each month. During 2022, the Group continued to have a significant proportion of its liquid assets deposited with the Bank of England.

Capital Risk: In order to conserve capital, the Group has not undertaken new lending since 2013. The Group meets all the quantitative and qualitative requirements regarding the level of regulatory capital it must hold. Coupon payments on the Group's PIBS have been paid throughout the year. However, the risk of an external stress event such as a severe downturn in the housing market in either the UK or Spain, a regulatory requirement to hold additional capital or a change in accounting standards means that there remains uncertainty over the Group's ability to make coupon payments in the medium to long-term.

Interest Rate Risk: The Group's mortgage and savings products have different interest rate types and differing maturity profiles. This means that the Group is exposed to movements in interest rates. A movement in an external interest rate (e.g. Bank of England Base Rate) does not always affect every mortgage and savings product that the Group holds. The Group has more fixed rate mortgage products (notably its lifetime mortgages) than it has fixed rate savings products. Presently, there are no interest rate swaps in place to mitigate the risk. The interest rate risk position is monitored by the Risk Committee and the Board and is managed via the setting of internal policy limits and through the holding of an ascribed level of regulatory capital to mitigate the risk of interest rate movement. The Board has considered this risk by its review of financial projections under differing interest rate scenarios over the long-term. The Group has a natural partial hedge provided by fixed coupons on capital and some savings products.

The Board does not intend to hedge its fixed rate mortgages using interest rate swaps at this time; this position is monitored regularly. A rise in interest rates gives rise to a risk of decreasing margins as a greater portion of the mortgage portfolio than the deposit portfolio is based on fixed rates. Liquidity risk can also be managed through changes in the interest rate of the deposit book.

Currency Risk: The Group faces currency movement risks on its Euro-denominated mortgage balances which represent 25% of total mortgage assets as at 31 December 2022 (2021: 21%). The exchange rate risk arising on these balances is managed and partially mitigated by transacting foreign exchange forward contracts. In 2022 a £0.9m foreign exchange gain within Other Operating Income was largely offset by £0.6m of foreign exchange losses within Other Impairment Losses. The £0.3m net gain related to imperfectly matched positions and movements in forward points. The exchange rate risk position is reported to the Asset and Liability Committee ('ALCO') and Board each month.

Economic Risk: The Group faces the risk that its interest margin can become subjected to the pressure that is brought to bear from being an institution that is primarily funded through retail deposits. Within this market, there is great competition for attracting retail deposits at sustainable rates of interest. Market rates offered by retail institutions have begun to increase following the increases seen in the Bank of England base rate of interest and the end of the Bank of England's Funding for Lending and Term Funding Schemes. This leads to upward pressure on the Society's savings rates to prevent unwanted outflows.

The Group is also exposed to movements in the value of residential and commercial property in both its mortgage impairment provision requirements and the Group's investment properties which are held at fair value.

The macroeconomic assumptions used in calculation of expected credit losses are shown on page 38.

Political Risk: The UK's exit from the EU in January 2020 continues to create additional uncertainties for the economy, financial markets, housing and mortgage markets, government policy and financial services regulation. The impact upon borrower behaviour and collateral values within the Spanish lifetime portfolio remains uncertain. The Group has taken legal advice and contacted the regulatory authority in Spain and believes that operational risk in relation to the servicing of the loan book is limited.

The Government's response to increasing energy costs in 2022 and the Bank of England's increases to interest base rates each had some impact on slowing the rate of inflation in light of increases due to supply issues caused by the war in Ukraine. The ongoing support to be given and the Bank of England's future strategy on base rates remains uncertain. Unemployment levels and house prices have particular impacts upon the Group's credit risk.

Climate Change Risk: The Society has started to assess how climate change may impact its business. This includes the impact of increased incidents of flooding on the value of some properties within its mortgage portfolio and impacts on borrowers of requirements for minimum efficiency standards for their homes or rental properties. The PRA requires all financial institutions to nominate an individual to be responsible for incorporating the financial risks from climate change into existing risk management practices. The Society's Finance Director has been given this role and no significant risks have been identified but work to develop greater understanding of the risks and develop plans for how it can respond continues.

Cyber Risk: The Group faces the risks of inappropriate disclosure of personal or sensitive information and inappropriate access to internal data sources, in particular, cyber security threats to the Society and its Members as a result of attacks through the use of computer systems. The Society has appropriate controls in place and uses third party expertise to mitigate this risk. The Group holds cyber insurance to further mitigate any potential financial loss or disruption.

Regulatory Risk: As a regulated entity, the Group is exposed to risks arising from a failure to adhere to relevant regulation. In order to minimise this risk, the Group has deployed a number of risk management policies and procedures. The Group's Risk Management Framework ("RMF") is designed around the present needs of the Group. The RMF includes the responsibilities of the Board, the Risk Committee, the Operational Risk and Conduct Committee and Management as to how the Group meets, monitors and reports on its regulatory requirements. Oversight of Regulatory Risk is the responsibility of the Compliance function and is led by the Operational Risk and Compliance Manager.

The majority of the regulatory requirements that the Group faces are laid down by the PRA and the Financial Conduct Authority ("FCA"). The Group monitors developments in all relevant aspects of financial service regulation and undertakes assessments of the present and future impacts of such. Appropriate actions are taken to strengthen controls and amend the Group's strategy to meet changing regulatory requirements.

In addition to considering the impact of any non-compliance on the recoverability of loan balances and thus impairment provisioning, the Group considers the conduct risk which arises from having originated regulated loans and having acquired regulated loan portfolios. As is the case for all financial institutions there is a risk that aspects of current or historic business might be considered as not being conducted in accordance with all relevant regulation, or the fair and reasonable treatment of customers.

Certain activities of the Group, particularly the NMB MAC and CLC second charge loan portfolios carry greater levels of conduct risk. The administration of the NMB MAC and CLC portfolios was brought in-house in December 2015 and following that transfer the historic conduct of these portfolios was reviewed in detail by management and redressed where appropriate.

DIVERSITY MATTERS

Gender Analysis: Below is a table summarising permanent, employed members of staff and directors by gender at 31 December 2022, with comparative positions for the previous year end:

	31-Dec-22			31-Dec-21		
	Male	**Female**	**Non-binary**	**Male**	**Female**	**Non-binary**
Directors	5	2	-	5	2	-
Staff	16	27	1	15	25	1
Total	**21**	**29**	**1**	**20**	**27**	**1**

Given the size and scale of the Group's operations and its headcount, it does not have any members of staff that would be considered for separate disclosure as "Senior Managers" in the above table.

SOCIAL, COMMUNITY AND HUMAN RIGHTS ISSUES

Stakeholders: The Group's members, staff and other stakeholders are key to its success and it is committed to its policy of ensuring that all are treated fairly and equally at all times.

Employees: The Group's policies ensure that discrimination on the grounds of race, colour, religion, belief, nationality, ethnic origin, gender, sex, sexual orientation, marital status, age, part time status and membership (or otherwise) of a trade union is not tolerated. Further, the Group also holds to its policy on disability. This is achieved via a wider policy approach to equal opportunity in the workplace. Training and development opportunities are presented to staff to allow them to acquire relevant professional qualifications, which, in turn, assist the Group in achieving its goals.

Outlook

Having concluded that a merger with Newcastle Building Society would provide the best outcome for members, the Board are committed to concluding such a merger in as timely a manner as possible.

The Group's Capital position, as outlined on page 4, is such that the Society expects to be able to make PIBS coupon payments in 2023 but the Board recognises that, in the absence of a merger, there is a risk that these payments may not be secure in the medium to long-term.

The ongoing impact of high levels of inflation and the governmental and Bank of England responses continue to generate additional uncertainty and risk to the economy as a whole and to the Group. Following the UK's departure from the European Union, the impact on UK government policy, the financial markets and the wider UK economy in the medium to long-term remains uncertain. The Board will continue to monitor these risks, in particular with regard to the Group's Spanish lifetime portfolio.

The Group's latest medium to long-term strategic plan, in the absence of a merger, supports the strategy of reducing the balance sheet so as to conserve regulatory capital. Whilst working towards completing the merger, the Group's focus remains on delivering to that plan.

D.A. Harding
Chairman
28 February 2023

DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2022

Information presented in other sections of the Annual Report and Accounts

Certain information which is required to be included in the Directors' Report has been included in the separate Strategic Report. This information is deemed to form part of the Directors' Report:

- The Group's profitability and financial position
- The principal risks and uncertainties facing the business
- Outlook for the business
- Detailed financial risk management disclosures are provided in Note 1.

Directors

H.F. Baines	Vice Chairman
I.A. Dewar	Non-executive director
D.A. Harding	Chairman
J. Lincoln	Non-executive director
P.A. Lynch	Chief Executive
F.B. Smith	Non-executive director
M.A. Winterbottom	Finance Director

At the Annual General Meeting, D.A. Harding, F.B. Smith and M.A. Winterbottom will retire and being eligible, will offer themselves for re-election.

At the year-end no director had an interest in any shares or debentures of the Society or its connected undertaking.

Other matters

Charitable & political donations

The Society made charitable donations totalling £1k (2021: £1k) during the year. No contributions were made for political purposes.

Pillar 3 Disclosure

The Society's Pillar 3 disclosure is available to read on its website at https://www.themanchester.co.uk/Main/FinancialInformation

Supplier payment policy & practice

The Group's policy concerning the payment of its trade creditors is as follows:

a) to agree the terms of payment with a supplier;
b) to ensure that suppliers are aware of the terms of payment;
c) to pay invoices in conformity with the Group's contractual and other legal obligations.

Trade creditors at 31 December 2022 amounted to 1 day of average supplies (2021: 9 days).

Going Concern

The directors consider that it is appropriate for the financial statements to be prepared on a going concern basis of accounting as fully explained in Note 1 on page 26, which sets out the risks and uncertainties assessed as part of the preparation of the financial statements.

Independent Auditors

As PricewaterhouseCoopers LLP have completed 10 years as auditors of the Group, a tender process is required prior to appointing auditors for the 2023 Annual Report and Accounts.

On behalf of the Board of Directors
D.A. Harding
Chairman
28 February 2023

CORPORATE GOVERNANCE

The Board is responsible for setting strategy and providing leadership within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board is mindful that ownership of the Society rests with its members and that the provision of appropriate products is its key aim.

In order to ensure that, as a mutual organisation, it is appropriately governed, the Society has regard to the principles of the UK Corporate Governance Code ("the Code"), which is issued by the Financial Reporting Council ("the FRC") (located at: https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code).

Whilst the Code is more directly relevant to listed companies, its provisions can be adopted by a mutual organisation. The Society does not apply the revised code, however it includes additional governance disclosures to the extent deemed reasonable and appropriate by the Board.

At 31 December 2022 the Board consisted of two executive directors and five non-executive directors. Two different individuals hold the roles of Chairman and Chief Executive.

All non-executive directors are considered to be independent, except for the Chairman who, by the nature of the role that he holds, is not considered to be wholly independent. H.F. Baines was nominated by the Board as the Senior Independent Director. The role of the Senior Independent Director includes being available to members, where contact through the normal channels has failed or where such contact is inappropriate.

On matters where Board approval is required, each director has a single vote; there is a majority of non-executive directors on the Board.

APPOINTMENTS TO THE BOARD

There were no new director appointments during 2022.

The Remuneration and Nominations Committee's appointment process focuses on members of the business community in order to identify suitable candidates with specific relevant skills and experience.

On joining the Board, each director is provided with an induction which includes reading material and meetings with the Chief Executive Officer and certain managers. Through a programme of self-managed continuing personal development, each director ensures that they maintain a level of knowledge and skill commensurate with his or her role within the Group.

The Code identifies that a term of more than nine years for a non-executive director could impair, or could appear to impair, that director's independence. Three of the non-executive directors, including the Chairman, completed their nine-year terms during 2022 and a further non-executive director did so in January 2023. The Board have satisfied themselves that the affected non-executive directors remain independent and given the ongoing work towards completing a merger with Newcastle Building Society, the existing directors were asked and agreed to remain in position beyond their nine-year term.

At the Annual General Meeting in April 2023, D.A. Harding, F.B. Smith and M.A. Winterbottom will retire and being eligible, will offer themselves for re-election.

FINANCIAL AND BUSINESS REPORTING

The respective responsibilities of the directors and the Independent Auditors for preparing and reporting on the Annual Report and Accounts are contained within the Statement of Directors' Responsibilities and the Independent Auditors' Report.

REMUNERATION

During 2022, bonus payments for the executive directors were approved by the Remuneration and Nominations committee.

No director is involved in the discussion of, or Board voting activity, that relates to his or her own remuneration.

The remuneration policy for directors is contained within the Remuneration Report and service contract details may be found in the Annual Business Statement. Details of directors' remuneration are contained in Note 8 to the financial statements.

INTERACTION WITH SHAREHOLDERS

The "shareholders" of the Group are its borrowing and investing members. Unlike a PLC, each member can only have one vote and as a result there are no "major" or "significant" shareholders whose views can be canvassed for the Board. There are few opportunities for the Group to consult with its members. The Annual General Meeting ("AGM") provides one such opportunity and all Board members are available at this meeting in order to discuss Society matters with any attending members.

Details of the AGM are sent out to every member; all are encouraged to vote, either in person or by proxy.

THE BOARD AND ITS COMMITTEES

In order to execute its responsibilities in an efficient manner, the Board has constituted seven Committees, of which four (Audit, Remuneration & Nominations, Disclosure and Risk) are oversight Committees and three (Assets and Liabilities Committee ("ALCO"), Credit and Operational Risk & Conduct) are executive Committees. The Board retains responsibility for the setting of strategy and the approval of all policy matters. The four oversight Committees are responsible for a more detailed review of matters in their specialist areas, making recommendations to the Board as appropriate. The focus of the three executive Committees is on more day-to-day operational matters, operating within the Board-approved policy framework. Operational matters are delegated to the executive directors and staff, within specified mandates, in order to ensure that timely decisions can be taken in support of the Board's strategy and policy limits. In addition, the non-executive directors meet periodically to assess all aspects of governance, board responsibility and board performance.

CORPORATE GOVERNANCE

Assets and Liabilities Committee ("ALCO")

ALCO meets monthly to consider matters relating to liquidity and treasury management, including interest rate risk, treasury counterparty risk, exchange rate risk and interest margin management.

Membership as at 31 December 2022: M.A. Winterbottom (Chairman), C. Blore*, D. Callaghan*, P.A. Lynch.

(not a director)*

Audit Committee

The Committee's membership includes directors who are considered to be independent and its Chairman has experience in accounting and auditing matters. The Committee receives reports from the Group's internal and external auditors and from the Compliance function; its focus is in relation to compliance with statutory and regulatory requirements and systems and control matters, including assessing the effectiveness of risk systems delivered via a rolling Internal Audit Plan which is approved on an annual basis and covers elements of the control environment.

The Committee monitors and approves any non-audit work undertaken by the external auditors, which relates to seeking professional advice on accounting and tax matters. Non-audit work performed by PricewaterhouseCoopers LLP during 2022 consisted of standard tasks required in order to comply with the Building Society Act, including examination of the Group's Summary Financial Statements, Country By Country Reporting and Section 68 Related Party Reporting. This work was approved by the Audit Committee. The Committee monitors the financial reporting process, the statutory audit and all financial information that is disclosed externally.

Membership as at 31 December 2022: J. Lincoln (Chairman), I.A. Dewar and F.B. Smith.

During the year the committee's focus and key responsibilities consisted of the following:

Review of Financial Reporting matters including:

- Monitoring the integrity of the Group's financial statements and reviewing critical accounting policies, judgments and estimates.
- Reviewing the appropriateness of the going concern basis for preparing the financial statements.
- Providing advice to the Board on whether the Annual Report and Accounts give a true, fair and balanced view and are understandable to the members and other external interested stakeholders.

Within the key judgment areas the committee reviewed and considered the following areas as being the most significant for the Group:

- Loan loss provisions and the assumptions used to determine the level of provisions required for all portfolios including the Spanish lifetime book.
- Going concern accounting.

External Audit oversight and review including:

- Reviewing the objectivity and independence of external audit and assessing the level and appropriateness of non-audit services.
- Considering the appointment, removal, performance and remuneration of the external audit firm.
- Considering the planning, scope and findings of the external audit, challenges raised on key assumptions and scepticism demonstrated, the receipt of, and responses to the auditors' management letter and reviewing the degree of discussion and cooperation with internal audit .

Internal Controls and Risk Management including:

- Reviewing the adequacy and effectiveness of the Group's internal controls and risk management systems in conjunction with reviewing reports produced by internal and external audit.
- Reviewing the statements to be included in the Annual Report concerning internal controls and risk management.
- Oversight of the Group's whistleblowing policy.
- Development of a structured risk management framework.

Reviewing Internal Audit findings including:

- Considering and approving the strategic and annual plans of audit and compliance work.
- Considering management responses to recommendations and ensuring the prompt action of those responses.
- Considering the appointment, removal, performance and remuneration of the internal audit function.
- Considering the internal controls supporting the business operations.

The committee performs an internal self-assessment of its obligations and concluded that it had discharged its duties appropriately and in line with its Terms of Reference.

Operational Risk and Conduct Committee

The Committee ensures that the Board-approved conduct, operational risk appetite and operational risk framework matters are deployed and managed in a suitable manner.

Membership as at 31 December 2022: P.A. Lynch (Chairman), J. Johnson*, R. Mervill*, M. Tang*, M.A. Winterbottom, G. Worthington*.

(not a director)*

Credit Committee

The Committee meets monthly to ensure that the Board-approved credit risk appetite and lending-related policy matters are deployed and managed in a suitable manner.

Membership as at 31 December 2022: P.A. Lynch (Chairman), C. Blore*, D. Spencer*, M.A. Winterbottom.

(not a director)*

Disclosure Committee

The Committee meets as often as is required to monitor inside information and arrange for its release to the market. In any event, the Committee will meet at least once each year to undertake a review of the Group's systems and procedures relative to the discovery, disclosure and control of inside, regulatory and other sensitive information.

Membership as at 31 December 2022: D.A. Harding (Chairman), P.A. Lynch and M.A. Winterbottom.

Remuneration and Nominations Committee

The Committee is responsible for making recommendations to the Board in relation to the appointment of new directors, keeping under review the mix of skills and experience of the Board, and also in relation to the levels of remuneration for all Board members and certain managers, as well as policy matters affecting other employees of the Group.

Membership as at 31 December 2022: H.F. Baines (Chairman), I.A. Dewar, D.A. Harding, J. Lincoln, F.B. Smith.

Risk Committee

In its oversight capacity, the Committee assesses, determines, recommends, oversees and monitors the Society's risk appetite and promotes a risk based approach to the Society's activities.

The Committee reviews and recommends proportionate risk strategies, limits, tolerances, structures, and methodologies to manage, mitigate, avoid or transfer risks arising from the Society's activities and ensuring alignment to the Society's regulatory requirements.

Membership as at 31 December 2022: I.A. Dewar (Chairman), J. Lincoln, P.A. Lynch, F.B. Smith, M.A. Winterbottom.

Board and Committee attendance records for 2022

Attendance at full meetings of the Board and its Committees throughout 2022 is scheduled below. Figures displayed in brackets represent the number of meetings that any individual director was entitled to attend.

Board	Board	ALCO	Audit	Operational Risk & Conduct	Credit	Disclosure	Remuneration & Nominations	Risk
H.F. Baines	11 (11)	-	-	-	-	-	4 (4)	-
I.A. Dewar	11 (11)	-	4 (4)	-	-	-	4 (4)	7 (7)
D.A. Harding	11 (11)	-	-	-	-	-	4 (4)	-
J. Lincoln	11 (11)	-	4 (4)	-	-	-	4 (4)	7 (7)
P.A. Lynch	11 (11)	9 (9)	-	7 (7)	11 (11)	3 (3)	-	7 (7)
F.B. Smith	11 (11)	-	3 (4)	-	-	-	4 (4)	7 (7)
M.A. Winterbottom	11 (11)	8 (9)	-	7 (7)	10 (11)	3 (3)	-	7 (7)

The above figures exclude instances where directors have chosen to attend a meeting where they were not a member of that Committee and at which his or her attendance was not strictly required. Also excluded from the above are ad hoc Board and Committee meetings called at short notice and where the agenda items considered were very restricted in nature.

Internal Control

The Board is responsible for ensuring the effectiveness of the Group's systems of risk management and internal control, which are designed to identify, monitor and manage the Group's risks, rather than to eliminate them completely. Through various policies, procedures and appetite statements and with the implementation of a variety of operational control processes, the Board ensures that the Group's risks are managed appropriately and proportionately.

The Group's Risk Committee assesses, monitors and manages the significant risks faced by the Group, overseeing the promotion of a risk based approach to the Group's activities in line with the approved risk appetite for areas of operations.

Directed by the Audit Committee, Internal Audit reviews the control environment throughout the year and reports its findings to the Audit Committee regularly.

Following its annual review of all control activities undertaken in the year by management, internal auditors, external auditors and the Compliance function, the Audit Committee has satisfied itself that, commensurate with the size and risk profile of the current operations of the Group, its systems are effective.

Evaluation

The non-executive directors, led by the senior independent director, are responsible for assessing the performance of the Chairman. The Chief Executive attends the Chairman's appraisal in order for executive views to be taken into consideration.

On an annual basis, the Board and its Committees undertake a process of assessing and formally documenting their performance during the year using a checklist that covers all areas of operation. Contributions are sought from both Board and Committee members and other relevant parties. The Board reviews and approves the written assessments undertaken by all Committees and where required, amendments are made to the Board Procedures as a result of the assessment processes.

DIRECTORS' REMUNERATION REPORT

Introduction

The purpose of this report is to provide details of the Group's policy on the remuneration of its executive and non-executive directors and to explain the process for setting the level of directors' remuneration.

Remuneration and Nominations Committee

The Remuneration and Nominations Committee is responsible for the remuneration policy for all of the directors; it also reviews the remuneration of certain managers. All recommendations made by the Remuneration and Nominations Committee are considered by the full Board. The Committee has regard to best practice as set out in the UK Corporate Governance Code and with the PRA Remuneration Code to the extent that it is relevant to the Group, given that the Society is a mutual institution.

Executive directors

Remuneration levels are set for the executive directors so as to reward and retain the skills and commitment necessary to manage the development of the Group within a competitive and challenging business sector. In accordance with best practice, the Remuneration and Nominations Committee reviews the remuneration arrangements for the executive directors on a periodic basis and compares his or her range of benefits to those available within similar organisations. The Committee's objective is to promote suitable risk management arrangements, avoiding remuneration structures that promote excessive risk taking.

The executives' remuneration arrangements include:

- salaries, reviewed by the Committee on an annual basis;
- membership of the Group personal pension scheme, on the same terms as other eligible employees of the Group;
- taxable private health care.

Non-executive directors

Non-executive directors are remunerated by way of fees, which are recommended to the Remuneration and Nominations Committee by the Executive Directors and approved by the Board on an annual basis. The level of fees is assessed on the basis of responsibility, experience, skill and time commitment and by comparison with other building societies and regional financial institutions.

Non-executive directors do not receive any other benefits; they do not have any pension arrangements through the Group.

All directors

The Group does not make mortgage loans available to any director. The above arrangements applied throughout 2022.

Other business interests

Details of directors' other business interests are shown in the Annual Business Statement.

Directors' emoluments

The full directors' emoluments table may be found in Note 8 to the financial statements.

Summary

This report, in addition to Note 8 to the financial statements, is intended to provide a full explanation of the policy and application of directors' remuneration. A resolution will be put to the Annual General Meeting inviting members to vote on the Directors' Remuneration Report.

On behalf of the Remuneration and Nominations Committee
H.F. Baines
Chairman
28 February 2023

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Directors' responsibilities for preparing the Annual Report and Accounts

The following statement, which should be read in conjunction with the Statement of the Auditors' responsibilities on page 21, is made by the directors to explain his or her responsibilities in relation to the preparation of the Annual Report and Accounts in accordance with applicable law and regulation.

The directors are required by the Building Societies Act 1986 (''the Act'') to prepare financial statements for each financial year. The directors have prepared the Group and Society financial statements in accordance with international accounting standards in conformity with the requirements of the Building Societies Act 1986. Additionally, the Financial Conduct Authority's Disclosure Guidance and Transparency Rules require the directors to prepare the Group financial statements in accordance with UK-adopted International Accounting Standards.

In preparing the financial statements, the directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether, for the Group and Society, international accounting standards in conformity with the requirements of the Building Societies Act 1986 and, for the Group, international financial reporting standards adopted pursuant to UK-adopted International Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements ; and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Group and Society will continue in business.

In addition to the financial statements, the Act requires the directors to prepare, for each financial year, an Annual Business Statement and a Directors' Report, each containing prescribed information relating to the business of the Group and the Society.

Directors' responsibilities pursuant to the Disclosure and Transparency Rules

The directors confirm that to the best of each person's knowledge and belief:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and Society; and
- the Annual Business Statement and Directors' Report includes a fair review of the development and performance of the business and the position of the Group and Society, together with a description of the principal risks and uncertainties that they face.

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Society:

- keeps accounting records in accordance with the Building Societies Act 1986; and
- takes reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the Prudential Regulation Authority under the Financial Services and Markets Act 2000.

The directors have general responsibility for safeguarding the assets of the Group and Society, the qualitative standards for the level of CET 1 regulatory capital and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

In so far as each of the directors is aware:

- there is no relevant audit information of which the Group's auditors are unaware; and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

The directors are responsible for the maintenance and integrity of the Society's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board of Directors
D.A. Harding
Chairman
28 February 2023

INDEPENDENT AUDITORS' REPORT

TO THE MEMBERS OF MANCHESTER BUILDING SOCIETY

Report on the audit of the annual accounts

Opinion

In our opinion, Manchester Building Society's Group annual accounts and Society annual accounts (the "annual accounts"):

- give a true and fair view of the state of the Group's and of the Society's affairs as at 31 December 2022 and of the Group's and the Society's income and expenditure and the Group's and the Society's cash flows for the year then ended;
- have been properly prepared in accordance with UK-adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Building Societies Act 1986.

We have audited the annual accounts, included within the Annual Report (the "Annual Report"), which comprise: the Group and Society statement of financial position as at 31 December 2022; the Group and Society income statement and statement of comprehensive income, the Group and Society statement of cash flows, and the Group and Society statement of changes in equity for the year then ended; and the notes to the annual accounts, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the annual accounts section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the annual accounts in the UK, which includes the FRC's Ethical Standard applicable to public interest entities and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group.

Other than those disclosed in note 6 to the annual accounts, we have provided no non-audit services to the Group in the period from 1 January 2022 to 31 December 2022.

Material uncertainty relating to going concern – Group and Society

In forming our opinion on the annual accounts, which is not modified, we have considered the adequacy of the disclosure made in note 1 to the annual accounts concerning the Group's and Society's ability to continue as a going concern. The directors have set out the plan of the Group in pursuing a merger with Newcastle Building Society.

The merger is in advanced stages with both parties signing Head of Terms in February 2023, however, final regulatory approval is still pending. If regulatory approval is obtained, the PRA will direct the merger following resolution at the Board level, forgoing the requirement of a member's vote, and the merger would be completed within twelve months of the approval of the accounts.

If the merger is successful there will be a transfer of property, rights and liabilities from the Group and Society to Newcastle Building Society. Following this, the Society's authorisation to continue as a registered entity will be revoked by the FCA with the Group and Society being subsequently dissolved.

As the signed Heads of Terms are non-binding there are a range of potential scenarios that may result in the merger falling through in which case, the Group will continue to follow their strategic plan of orderly winding down of operations.

These conditions, along with the other matters explained in note 1 to the annual accounts, indicate the existence of a material uncertainty which may cast significant doubt about the Group's and the Society's ability to continue as a going concern. The annual accounts do not include the adjustments that would result if the Group and Society were unable to continue as a going concern.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the Group's and the Society's ability to continue to adopt the going concern basis of accounting included:

We reviewed the signed non-binding Head of Terms to understand the scope and timeline of the merger, including confirmation that a successful merger will result in the transfer of property, rights and liabilities to Newcastle Building Society. We determined whether there are any impediments which reduce the likelihood of a successful merger and confirmed the Group and Society have appropriately met legal and regulatory requirements to facilitate a successful merger in the next 12 months.

We held direct discussions with the PRA to understand their outlook on the merger. This involved discussing the level of supervision that would be maintained during the merger process, specifically with respect to the PRA's discretion to exempt the requirement of a member's vote. We read regulatory correspondence to gain an understanding of the Board's and the PRA's approach to ongoing supervision under a range of potential future scenarios.

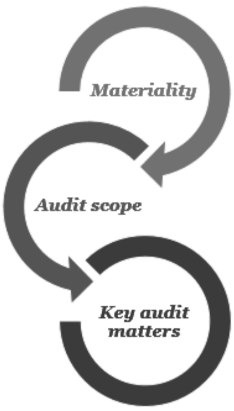
We assessed the board's contingency strategies in the event of an unsuccessful merger. We corroborated this against the Group's and Society's capital headroom at 31 December 2022 and recalculated management's workings to ensure consistency with audited financial information. We reviewed the future base case forecasts contained within the plan and considered whether these are consistent with the audit evidence obtained in our current year procedures. We performed an additional stress test scenario to cover downside risk and determine whether capital resources remain adequate.

We also assessed whether the directors' disclosures in relation to going concern adequately reflected the risks and uncertainties facing the Group and Society based on our understanding of the business.

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

Our audit approach

Overview



Materiality

- £370k (2021: £352k) - Group annual accounts
- Based on 1% of Group net assets
- £341k (2021: £326k) - Society annual accounts
- Based on 1% of Society net assets

Scoping

- We conducted all our work in Manchester using one audit team.
- We have performed procedures over all material account balances and financial information of the Society due to its financial significance to the Group's financial performance.
- We performed audit procedures over specific account balances and financial information in the one other Group undertaking that materially contributed to the Group's financial performance and/or position.

Key audit matters

- Going concern (Group and Society) - see Material uncertainty relating to going concern section above
- Management judgements and modelling decisions for loan loss under IFRS 9 (Group and Society).
- Spanish lifetime mortgage provisions (Group and Society).
- IFRS 17 Transition (Group and Society)
- NMB MAC loan book provisioning (Group).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the annual accounts. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits we also addressed the risk of management override of internal controls, including evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Capability of the audit in detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined in the Auditors' responsibilities for the audit of the annual accounts section, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the Group/industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK regulations, such as those governed by the Prudential Regulatory Authority and UK tax legislation, and we considered the extent to which non-compliance might have a material effect on the annual accounts. We also considered those laws and regulations that have a direct impact on the annual accounts such as the Building Societies Act 1986. We evaluated management's incentives and opportunities for fraudulent manipulation of the annual accounts (including the risk of override of controls), and determined that the principal risks were related to the posting of inappropriate journal entries to increase income or reduce expenditure, including management bias in accounting estimates. There may be a greater risk of management bias to improve the capital position of the Society or ensure a favourable outcome on the proposed merger. Audit procedures performed included:

- Discussions with management and those charged with governance in relation to known or suspected instances of non-compliance with laws and regulation and fraud;
- Review of internal audit reports in so far as they related to the financial statements;
- Review of correspondence with and reports to the regulators;

- Challenging assumptions and judgements made by management in their significant accounting estimates (see key audit matters below); and
- Testing of journal entries which contained unusual account combinations back to corroborating evidence.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the annual accounts. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the annual accounts of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, 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. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Going Concern (Group and Society - see Material uncertainty relating to going concern section above) and IFRS 17 Transition (Group and Society) are new key audit matters this year. Otherwise, the key audit matters below are consistent with last year.

Key audit matter	***How our audit addressed the key audit matter***
Going Concern (Group and Society)	See material certainty relating to going concern section above.
Management judgments and modelling decisions under IFRS 9 (Group and Society) The Group and Society use impairment models to calculate impairment losses on loans and advances to customers, being £374k and £390k respectively (2021: gain of £151k and £278k) in the year. This excludes Spanish lifetime mortgages and other portfolios where impairment is assessed individually. Under the IFRS 9 impairment models, losses are recognised on an 'expected credit loss' (ECL) basis. The calculation of expected credit losses requires the use of forward looking information, reflecting management's view of potential future economic scenarios. The standard also requires management to make judgments regarding when a loan has experienced a 'significant increase in credit risk' and to make assumptions regarding expected customer default rates and repayment behaviour. In order to meet the requirements of the standard, management depends on previous behaviour observed in the loan portfolios as well as relevant external data which is used to set assumptions within the impairment models. We consider the appropriateness of the model methodologies and the following assumptions used in the determination of the modelled expected credit loss to be significant: • The thresholds and definitions applied by management to determine a significant increase in credit risk. These determine whether a 12 month or a lifetime expected loss provision is recorded against each loan; • The determination of forward looking macroeconomic scenarios weights applied to ECLs associated with each scenario; and	We tested underlying data used within the models to evidence from original loan documentation, for example by agreeing a sample of property values in models to latest valuations provided by external third parties, and re-calculating current and forecast collateral values. We tested whether management's assessment of when a loan has suffered a significant increase in credit risk was sufficient in order to capture observable loan indicators which may imply that the loan has suffered a deterioration in credit quality. We performed tests to determine whether management's definition of default included within the expected loss calculation was aligned with the Society's arrears management process. We compared management's base case forward-looking economic assumptions to alternative external forecasts to assess their reasonableness. The severity and magnitude of the alternative scenarios used within the model were compared to external stress scenarios and data from historical economic downturns to determine whether they represented sufficient stresses to meet the requirements of the standard. We used this analysis to test the reasonableness of management's assigned weightings to each scenario in the ECL calculation. We involved risk modelling specialists to re-perform and review the outputs of model calculations to ensure the accuracy of the underlying model. They also assisted in the consideration of the appropriateness of economic forecasts adopted and the overall compliance of the modelling solutions within underlying IFRS 9 requirements. We considered the overall condition of the Group's and Society's loan book, and how this is changing over time. We considered whether there are any emerging risks (including the cost of living crisis) that are not captured within the impairment policy when considering the appropriateness of the overall expected credit loss. For post model adjustments we tested their

Key audit matter	*How our audit addressed the key audit matter*
• The completeness and appropriateness of post model adjustments to account for areas of increased risk within the portfolios or model limitations. In addition, management perform individual impairment assessments for large loan exposures where unique circumstances mean that significantly more management judgement is required to determine the level of provision required. Our focus within this aspect of the models was on the principal assumptions applied by management in estimating impairment provisions such as the valuation of collateral, forecast and timing of future cash flows and the completeness and severity of considered future scenarios. Further information can be found in Note 1 to the annual accounts, which includes the directors' disclosures of the related accounting policies, judgments and estimates; and in Note 12 for detailed disclosures.	implementation into the final output and that the underlying rationale and methodology were appropriate. For a sample of the individually assessed loans, we tested supporting data used back to historic transactions. We reviewed the mortgage files and used these to develop independent assumptions, including assumed time to disposal and redemption cash flows on disposal of collateral to model our own scenarios. We used these scenarios and their ECL to assess whether management's ECL sufficiently captured the potential losses across a range of future scenarios. Where redemptions have occurred in the year we performed retrospective testing to previously recognised impairments to assess the models historical accuracy. Based on the procedures performed and the evidence obtained, we found management's judgments used in the determination of the ECLs to be reasonable.
Spanish Lifetime provisioning (Group and Society) The Group and Society has recognised an impairment charge on loans and advances to customers held on Spanish lifetime mortgages of £2,119k (2021: £1,440k) in the year, and at the year-end holds a total provision of £13,719k (2021: £12,257k). These mortgage assets contain contractual terms that give rise to the borrower not being obligated to make any repayments of the loan until their death or until they enter long-term care. The loans also contain a NNEG 'no negative equity guarantee' which results in the Group and Society bearing any losses on the mortgage at the time of redemption, as the Group and Society's claim is capped to the value of mortgaged property. The inclusion of 'NNEG' results in these loans being accounted for using insurance accounting standards. Management estimates the value associated with the provision of the insurance element and reflect this within the annual accounts at the year-end date as a reduction in the carrying value of the loan portfolio. These mortgage assets are secured on residential property in Spain. We consider the appropriateness of the methodologies and the following judgments used in the determination of the impairment charge to be significant: • Assumed customer longevity based on mortality assumptions; • Valuation of the Spanish properties, including the indexation of current values into the future; • Timing of customer redemption events including a portfolio prepayment rate which estimates the impact of redemptions occurring ahead of the forecast insurance event; and • Discount rate used to calculate the present value of future cash flows. Some of the data used to form these judgments is supplied by third parties to the Society.	We assessed management's accounting treatment for the portfolio through a review of loan terms and the underlying accounting requirements. This included an assessment as to whether the modelled solution created by management was in line with relevant accounting requirements. We tested the loan data associated with the provision calculations, which included agreeing a sample of loan information back to the Society's loan book administration system and underlying mortgage files. For a sample of loans, we agreed that the Society has rights to the cash flows arising from the ultimate sale of underlying collateral through review of certificates of charge. To assess the reasonableness of longevity data used within the calculation, we engaged our actuarial experts to review the third party data used within management's calculation. They compared the data used against industry sources and considered the specific circumstances regarding the Society's customer base for this portfolio. We tested a sample of properties in the portfolio with recent sales and compared this against the valuations performed by management's independent surveyors. We used this as a benchmark to determine the robustness of marketing appraisals obtained from estate agents in recent years. We performed a range of sensitivity analyses to understand how changes in forecast Spanish property prices impact the provision. We agreed the third party economic index data management use within the calculation back to source, and considered alternative sources and estimates as part of drawing our conclusions on the appropriateness of the data set used by management. We selected a sample of loans where a customer redemption event had taken place and reviewed the customer correspondence file to determine if trends existed within the population which may lead to an alternative rate.

Key audit matter	***How our audit addressed the key audit matter***
See Note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgments and estimates and Note 12 for detailed disclosures.	We tested the completeness and accuracy of the data set management uses to form judgments regarding the prepayment rate that the portfolio experiences and considered whether this supported management's assumption within their calculation methodology. We tested the reasonableness of the discount rate through comparison against the original contractual effective interest rate determined at the onset of the loans. We recalculated the weighted average rate utilised within the model to ensure it represented the range of rates across the mortgage portfolio. We considered the sensitivities on the discount rate and prepayment rate through developing a range of other feasible rates based on past performance of the loan book and industry benchmarks to understand how different rates used impacts the impairment charge. We checked the mathematical accuracy of the impairment calculation by testing formulae and ensuring consistent application across modelled accounts. Based on the procedures performed and the evidence obtained, we found management's judgments used in the calculation of losses on the portfolio to be reasonable
IFRS 17 Transition (Group and Society) As a result of upcoming changes in accounting standards effective for periods commencing from 1st January 2023, the Society will be required to implement IFRS 17 in the measurement of its lifetime mortgage portfolio as the loans contain a NNEG 'no negative equity guarantee' which results in the Group and Society bearing any losses on the mortgage at the time of redemption, as the Group and Society's claim is capped to the value of mortgaged property. Disclosures in 2022 are intended to provide users with an understanding of the estimated impact of the new standard, and as a result are more limited than those to be included within the 2023 financial statements. Under the new standard, the Society will be required to implement a new lifetime mortgage valuation model given the requirement to recognise the portfolio at fair value. See note 1 for management's disclosure of the change in accounting standards.	We involved risk modelling specialists to review the model developed by management's expert during the year. This included an assessment as to whether the modelled solution created by management's experts was in line with relevant accounting requirements. We identified key assumptions used in the model and benchmarked them against industry sources to assess their reasonableness. We reviewed the objectivity and independence of management's experts and determined whether they have sufficient knowledge in providing expertise to management. Based on the procedures performed and the evidence obtained, we found management's disclosures related to the expected impact to be reasonable.
NMB MAC provisioning (Group) The Group holds a portfolio of highly forborne loans regulated under the Consumer Credit Act which primarily involve a second charge over the collateral. The portfolio was purchased from a third party in 2007 and was considered to be credit impaired at acquisition under IFRS 9. Many of the loans within the portfolio are past their original contract term and therefore management have entered into individual arrangements with borrowers to make repayments. The Group has recognised an	We agreed management's forward looking economic data used back to source and confirmed that the providers were reputable. We performed sensitivity analysis on the data set used by management and considered alternative scenarios to understand how this may impact the recoverability of the portfolio. We performed testing to confirm that input data to the expected credit loss calculation was consistent with underlying loan book records and

Key audit matter	*How our audit addressed the key audit matter*
impairment gain on this portfolio of £16k in 2022 (2021: charge of £128k). At year-end the provision on this portfolio is £8,575k (2021: £8,592k) resulting in a net loan book £1,324k (2021: £1,643k). The portfolio remains in default and significant judgement needs to be applied by the directors to estimate the potential impairment loss associated with these loans. The estimate of loss on the portfolio is calculated by use of models to discount the future cash flows expected to be received on the loans. The calculation is impacted by a number of assumptions which we focussed on, including the following which were deemed to be the most significant: • The determination of different forward looking scenarios weights applied to ECLs associated with each scenario; • The value of the underlying security at the time of planned disposal relative to the forecast value of the remaining loan assets; and • The timing of likely redemptions, especially given that much of the portfolio is past term and subject to individual arrangements with borrowers to make repayments. See Note 1 to the annual accounts for the directors' disclosures of the related accounting policies, judgments and estimates and Note 12 for detailed disclosures.	records of customer correspondence from management agreeing revised repayment plans with borrowers relative to the terms of original customer loans. We obtained evidence over the existence of the Group's charge over a sample of assets within the portfolio. We tested the underlying data sets which were used by management to form assumptions on expected time to redemption of loan assets, collateral values at the point of sale and receipt of regular cash flows for customers where arrangements to pay have been agreed. We used past cash flow data to inform our assessment of management's assumptions regarding future recoverability from the portfolio, including the timing of assumed redemptions. In forming our assessment on management's provision we formed our own view of alternative future scenarios which could occur. We performed independent modelling of these scenarios to compare the ECL calculated under these scenarios with the provision recorded by management. Based on the procedures performed and the evidence obtained, we found management's judgments used in the determination of the ECLs to be reasonable.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the annual accounts as a whole, taking into account the structure of the Group and the Society, the accounting processes and controls, and the industry in which they/it operate.

All of the Group's and Society's activities are administered in the United Kingdom and it reports its operating results within a single business line, being the provision of facilities for personal savings and for mortgage finance, primarily to support owner occupation of residential property. The Society's mortgage book is predominantly secured on UK residential and commercial property, however the Society has a portfolio of lifetime mortgages secured on residential property in Spain. This portfolio makes up 18% of overall Group assets.

The Group is formed of the Society and its wholly owned subsidiary, MBS (Mortgages) Limited, which is material to the Group.

A significant proportion (98%) of the Group's total assets are owned by the Society, along with 97% of the Group's net interest income. Significant activity undertaken by MBS (Mortgages) Limited includes the provision of back book mortgage administration services to generate an appropriate return for the Society.

The accounting records and functions for all entities within the Group are located at the Society's principal office in Manchester, with consolidation of the Group annual accounts being performed from this location. We perform all of the work to support the Group and Society's opinion.
We performed audit procedures over all material account balances and financial information of the Society due to its significance to the Group's financial performance. We performed audit procedures over specific account balances and financial information in the subsidiary undertaking that materially contributes to the Group's financial performance and/or position. Our audit procedures on the Society and its subsidiary undertaking provided us with sufficient audit evidence as a basis for our opinion on the Group annual accounts as a whole.

The impact of climate risk on our audit

As part of our audit we made enquiries of management to understand the extent of the potential impact of climate risk on the Group and Society's financial statements, and we remained alert when performing our audit procedures for any indicators of the impact of climate risk. Management considers the impact of climate risk does not give rise to a potential material financial statement impact as set out in the risk management report and our procedures have not identified any material impact in the context of our audit over the financial statements.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the annual accounts as a whole.
Based on our professional judgement, we determined materiality for the annual accounts as a whole as follows:

	Group annual accounts	***Society annual accounts***
Overall materiality	£ 369,800 (2021: £253,000).	£ 340,700 (2021: £216,600).
How we determined it	1% of net assets.	
Rationale for benchmark applied	Net assets is one of the principal metrics used when assessing the Group's and Society's performance and is a generally accepted benchmark for determining audit materiality.	

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was £87,000 to £340,700.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% of overall materiality, amounting to £277,400 for the Group financial statements and £255,500 for the Society materiality.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount of our normal range was appropriate.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £17,000 (2021: £16k) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the annual accounts and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the annual accounts does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the annual accounts, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the annual accounts or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the annual accounts or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Annual Business Statement and Directors' Report we also considered whether the disclosures required by the Building Societies Act 1986 have been included.

Based on our work undertaken in the course of the audit, the Building Societies Act 1986 requires us also to report certain opinions and matters as described below.

Annual Business Statement and Directors' Report

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

- the Annual Business Statement and the Directors' Report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the Directors' Report for the year ended 31 December 2022 is consistent with the accounting records and the annual accounts; and
- the information given in the Annual Business Statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

In light of the knowledge and understanding of the Group and Society, and their environment, obtained in the course of the Audit, we did not identify any material misstatements in the Directors' Report.

Responsibilities for the annual accounts and the audit

Responsibilities of the directors for the annual accounts

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the annual accounts in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the annual accounts

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

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the annual accounts is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Society's members as a body in accordance with Section 78 of the Building Societies Act 1986 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Building Societies Act 1986 exception reporting

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Society; or
- the Society annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations and access to documents we require for our audit.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the members on 27 April 2022 to audit the annual accounts for the year ended 31 December 2022. The period of total uninterrupted engagement is 10 years, covering the years ended 31 December 2013 to 31 December 2022.

Daniel Brydon (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
28 February 2023

STATEMENTS OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2022

	Note	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Interest receivable	2	4,882	4,190	4,737	4,020
Other similar income	2	3,034	3,354	3,034	3,354
Interest payable and similar charges	3	(2,131)	(1,371)	(2,131)	(1,371)
Net interest income		5,785	6,173	5,640	6,003
Legal damages and interest	4	-	14,272	-	14,272
Fees and commission income / (expense)		5	(2)	5	(2)
Net loss on assets classified as held for sale	17	(155)	(194)	(155)	(194)
Other operating income	5	907	-	947	523
Other operating charges	5	(2)	(809)	(2)	(694)
Total operating income		6,540	19,440	6,435	19,908
Legal costs recovered	4	2,400	7,540	2,400	7,540
Administrative expenses	6	(5,287)	(4,733)	(5,253)	(4,707)
Amortisation	15	(11)	(11)	(11)	(11)
Depreciation	16	(91)	(110)	(91)	(110)
Operating profit before impairments and provisions		3,551	22,126	3,480	22,620
Expected credit (losses) / gains	13	(374)	151	(390)	278
Other impairment losses	13	(2,119)	(1,440)	(2,119)	(1,440)
Profit on ordinary activities before income tax		1,058	20,837	971	21,458
Income tax expense	9	-	(1,467)	-	(1,467)
Profit for the financial year		1,058	19,370	971	19,991

The Group and the Society have no other comprehensive income.

The notes on pages 26 to 64 form part of these financial statements.

STATEMENTS OF CHANGES IN EQUITY

	Group 2022				Society 2022			
	Retained earnings £000	Subscribed Capital £000	Profit Participating Deferred Shares £000	Total £000	Retained earnings £000	Subscribed Capital £000	Profit Participating Deferred Shares £000	Total £000
Balance at 1 January 2022	8,085	9,788	17,461	35,334	5,318	9,788	17,461	32,567
Transactions with equity holders - interest on PIBS	(675)	-	-	(675)	(675)	-	-	(675)
Profit and total comprehensive income for year	1,058	-	-	1,058	971	-	-	971
Balance at 31 December 2022	8,468	9,788	17,461	35,717	5,614	9,788	17,461	32,863

	Group 2021				Society 2021			
	(Accumulated losses)/ Retained earnings £000	Subscribed Capital £000	Profit Participating Deferred Shares £000	Total £000	(Accumulated losses)/ Retained earnings £000	Subscribed Capital £000	Profit Participating Deferred Shares £000	Total £000
Balance at 1 January 2021	(11,011)	9,788	17,461	16,238	(14,399)	9,788	17,461	12,850
Transactions with equity holders - interest on PIBS	(338)	-	-	(338)	(338)	-	-	(338)
Tax credit relating to interest on PIBS	64	-	-	64	64	-	-	64
Profit and total comprehensive income for year	19,370	-	-	19,370	19,991	-	-	19,991
Balance at 31 December 2021	8,085	9,788	17,461	35,334	5,318	9,788	17,461	32,567

STATEMENTS OF FINANCIAL POSITION

AS AT 31 DECEMBER 2022

	Note	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
ASSETS					
Liquid assets					
Cash and balances with the Bank of England	25	38,223	37,704	38,223	37,704
Loans and advances to credit institutions	10	5,016	10,589	5,015	10,588
		43,239	48,293	43,238	48,292
Derivative financial instruments	11	12	712	12	712
Loans and advances to customers					
Loans fully secured on residential property	12	120,991	141,209	118,252	138,143
Loans fully secured on land	12	10,937	11,891	10,937	11,891
Other loans	12	115	200	115	200
		132,043	153,300	129,304	150,234
Investments					
Subsidiary undertakings	14	-	-	1	292
		-	-	1	292
Intangible assets	15	33	44	33	44
Property, plant and equipment	16	143	229	143	229
Non-current assets classified as held for sale	17	291	491	291	491
Other assets	19	2,508	1,537	2,508	1,537
Total assets		178,269	204,606	175,530	201,831
LIABILITIES					
Due to members	20	129,389	150,254	129,389	150,254
Other deposits	21	6,195	7,036	6,195	7,036
Derivative financial instruments	11	956	9	956	9
Current income tax liabilities		-	686	-	686
Other liabilities	23	1,012	1,287	1,007	1,279
Subsidiary undertakings	14	-	-	120	-
Subordinated liabilities	22	-	5,000	-	5,000
Subscribed capital	24	5,000	5,000	5,000	5,000
Total liabilities		142,552	169,272	142,667	169,264
EQUITY					
Retained earnings		8,468	8,085	5,614	5,318
Subscribed capital	24	9,788	9,788	9,788	9,788
Profit participating deferred shares	26	17,461	17,461	17,461	17,461
Total equity		35,717	35,334	32,863	32,567
Total equity and liabilities		178,269	204,606	175,530	201,831

The financial statements on pages 23 to 64 were approved by the Board of Directors on 28 February 2023

D.A. Harding
Chairman

P.A. Lynch
Chief Executive

M.A. Winterbottom
Finance Director

STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2022

	Note	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Cash flows from operating activities					
Profit before tax		1,058	20,837	971	21,458
Adjusted for:					
Amortisation	15	11	11	11	11
Depreciation	16	91	110	91	110
Fair value adjustments	17	155	194	155	194
Disposal of non-current assets classified as held for sale		44	-	44	-
Income taxes paid		(685)	(717)	(685)	(717)
Interest on subordinated liabilities and subscribed capital		568	755	568	755
Cash flows generated from/ (used in) operating activities before changes in operating assets and liabilities		1,242	21,190	1,155	21,811
Increase / decrease in operating assets and liabilities					
Decrease in loans and advances to customers		21,240	27,930	20,898	27,395
Increase / (decrease) in provisions		17	(2,090)	32	(2,217)
(Increase) / decrease in other assets		(971)	709	(971)	709
(Decrease) / increase in other liabilities		(275)	366	(272)	366
Increase / (decrease) in derivative financial instruments		1,647	(635)	1,647	(635)
(Increase) in amounts owed by credit institutions		(23)	-	(23)	-
Decrease in other deposits		(841)	(1,800)	(841)	(1,800)
Decrease in amount due to members		(20,865)	(25,958)	(20,865)	(25,958)
Net cash flows generated from operating activities		1,171	19,712	760	19,671
Cash flow from investing activities					
Receipts from investments in subsidiary undertakings	14	-	-	411	41
Purchase of property, plant and equipment	16	(5)	(2)	(5)	(2)
Net cash flows generated from / (used in) investing activities		(5)	(2)	406	39
Cash flow from financing activities					
Interest paid on subordinated liabilities and subscribed capital		(1,243)	(1,093)	(1,243)	(1,093)
Repayment of subordinated liabilities	22	(5,000)	(9,200)	(5,000)	(9,200)
Net cash used in financing activities		(6,243)	(10,293)	(6,243)	(10,293)
Net movement in cash and cash equivalents		(5,077)	9,417	(5,077)	9,417
Cash and cash equivalents at start of year		48,293	38,876	48,292	38,875
Cash and cash equivalents at end of year	25	43,216	48,293	43,215	48,292

1. Accounting policies and financial risk management

a) Summary of significant accounting policies

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

Basis of preparation: going concern

The Group is in advanced talks with Newcastle Building Society with regards to a merger by way of a transfer of the Group's engagements to Newcastle. Heads of Terms were exchanged in February 2023 and the merger is expected to be completed within the next twelve months. However, the binding Instrument of Transfer has not yet been signed and any merger would still require regulatory approval. If regulatory approval is obtained, the PRA will direct the merger following a resolution of the Board, without the requirement for a member's vote. Until the binding Instrument of Transfer is signed, either Newcastle Building Society or the Group could choose not to proceed with the merger, though in some circumstances, doing so may result in a payment of costs being due to the other party.

Should the merger be concluded, all assets, rights, obligations and liabilities of the Group will transfer to Newcastle Building Society and the Group will cease to exist. Following this, the Society's authorisation to continue as a registered entity will be revoked by the FCA with the Group and Society being subsequently dissolved. As such, the merger indicates a material uncertainty which may cast significant doubt on the Group and Society's ability to continue as a going concern.

As the signed Heads of Terms are non-binding, there are a range of potential scenarios that may result in the merger falling through. The Group has not been active in the Mortgage market since 2013 and until the merger is concluded it continues to follow a medium to long-term strategic plan, against which it is monitored by the PRA. The plan shows that the Society remains viable at least through the next twelve months, regardless of whether the merger takes place, and the Society has significant capital headroom against this plan regardless of whether the merger takes place. Additionally, the plan shows that there is sufficient capital headroom, even when taking into account the potential for a stress event in the economy or financial markets such as a downturn in the housing market either in the UK or Spain, additional provision requirements on some of the Group's larger mortgage exposures, or a materially different mortgage repayment profile to that included within the plan. The impact of transitioning to IFRS 9 for the Group's Spanish Lifetime portfolio was also considered in the plan.

The financial impact of additional provision requirements in potential stresses on the UK loan portfolios is shown on page 38 and for the Spanish portfolio, based upon current methodology, on page 50.

When satisfying themselves that the Group and Society have adequate resources to continue to operate for the foreseeable future as a going concern, even if the proposed merger with Newcastle Building Society is aborted, the directors have reviewed the latest forecasts and the ability for the plan to be followed.

Having due regard to these matters, the Board continues to adopt the going concern basis of accounting in preparing the financial statements.

The Board considers the preparation of the financial statements as a going concern to be a critical accounting judgment. The annual accounts do not include the adjustments that would result if the Group and Society were unable to continue as a going concern.

Basis of preparation: accounting standards

The Group's financial statements have been prepared in accordance with UK-adopted International Accounting Standards- being International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) and interpretations (IFRICs) issued by the International Accounting Standards Board (IASB) endorsed by the UKEB (UK Endorsement Board) and effective from 1 January 2021 - and with those parts of the Building Societies Act 1986 and the Building Societies (Accounts and Related Provisions) Regulations 1998 applicable to building societies reporting under International Accounting Standards.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 1c.

Changes in accounting policies

No new accounting policies have been adopted in the year. Certain new accounting standards and interpretations have been published that are not mandatory for 31 December 2022 reporting periods and have not been early adopted by the Group. Other than IFRS 17 – *Insurance Contracts*, which is described on page 27, these standards are not expected to have a material impact on the entity in the current or future reporting periods and on foreseeable future transactions.

Basis of consolidation

The Group's financial statements include the financial statements of the Society and its subsidiary undertaking, MBS (Mortgages) Limited.

The Society and its subsidiary each have accounting periods ending on 31 December. The Society's Statement of Financial Position includes the investment in the subsidiary undertakings at cost, less any provision for impairment.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Interest income and expense

Interest income and expense is recognised in the Statements of Comprehensive Income for all financial instruments measured at amortised cost using the effective interest rate method. The effective interest rate method is a method of allocating the income or expense over the life of the financial instrument. The effective interest rate is the rate that exactly discounts estimated cash flows (excluding future expected credit losses) to the gross amount of the financial asset over the expected life of the instrument.

In calculating the effective interest rate all contractual terms of the financial instrument are taken into account, along with all fees paid or received, all transaction costs and any other premia or discounts.

Insurance contracts

The Group has a portfolio of lifetime mortgage loans secured on Spanish residential property. The "No Negative Equity Guarantee" clause of the mortgage contract meets the definition of an insurance contract; where a borrower dies or goes into long-term care and a redemption receipt from the sale of the property is less than the contractual sum owed the Group does not have any further ability to recover amounts from the borrower or the estate.

Under IFRS 4 the Group has continued to account for these mortgage contracts using its existing accounting policies. The mortgage contract has been classified as being not unbundled. The impact of assessing the contracts as being "not unbundled" is that the income earned on the mortgage contracts is not split between interest and insurance premium and that the mortgage asset is included within loans and advances at the present value of future cash flows. Accounting for these mortgage contracts under IFRS 4 is a critical accounting judgment.

Measurement and recognition of the income earned on the mortgage contract has been undertaken in line with the Group's other mortgage contracts; the income earned has been included in the Income Statement within the Other Similar Income category. Within the Statement of Financial Position, the mortgage asset is reported within the Loans and Advances to Customers category, net of any impairment provision.

The insurance risk liability associated with the no-negative equity guarantee is calculated by estimating potential shortfalls arising at redemption, discounted at the effective interest rate, and is represented by the impairment provision. The assessment incorporates assumptions relating to future house price values at the time of account redemption. Its assessment is also based on expected future outcomes relating to the date on which an account redeems which, given the nature of the product is expected to be on death of the borrower, but can be affected by health issues that would see borrowers move into care; it can also be affected by non-health related voluntary pre-payment. The insurance liability arising as a result of the no negative equity guarantee is presented within Note 12 to the financial statements as "Insurance risk provisions".

IFRS 4 is to be replaced by IFRS 17 – *Insurance Contracts* for accounting periods beginning on 1 January 2023. As allowed by the standard, the Society will opt to adopt IFRS 9 – *Financial Instruments* as opposed to adopting IFRS 17. As the portfolio does not pass the SPPI test, as described on page 28, this will result in the portfolio being measured at fair value through profit or loss ("FVPL") with movements in fair value being recognised in the income statement. This will lead to increased volatility of the income statement as the fair value calculation relies upon market wide borrowing costs which are outside the Society's control.

At present, based upon a detailed initial assessment, management estimates that the reduction in value of the Spanish lifetime portfolio on the adoption of IFRS 9 as at 1 January 2023 is in the range of £3.0m to £5.0m which will result in an equivalent reduction in reserves.

Fees and commissions

Fees and commissions relating to the origination of loans and advances to members are recognised within interest income using the effective interest rate method.

Other operating income

The Group recognises foreign exchange gains and losses and rents receivable as other operating income.

Financial Instruments

At initial recognition, the Group measures a financial asset or financial liability at its fair value. For financial assets or financial liabilities not held at fair value through profit or loss, adjustments are made for any transaction costs that are incremental and directly attributable. Transaction costs of financial assets and financial liabilities carried at fair value through profit or loss ("FVPL") are expensed in profit or loss. Immediately after initial recognition, an expected credit loss allowance ("ECL") is recognised for financial assets measured at amortised cost and investments in debt instruments measured at fair value through other comprehensive income ("FVOCI"). This results in an accounting loss being recognised in profit or loss when an asset is newly originated.

Financial assets

The Group classifies its financial assets in the following categories under IFRS 9:

(i) Financial assets at fair value through profit and loss

Derivative financial instruments. These instruments economically hedge the exchange rate risk on the Group's Euro-denominated Spanish mortgages. These instruments are carried at their fair value with changes in their fair value reflected in profit or loss as part of total operating income. Hedge accounting has not been applied by the Group.

Financial assets at fair value through profit and loss are subsequently carried at fair value. Fair values are obtained in line with the three tier hierarchy described in IFRS 13 from quoted market prices in active markets, revaluation techniques using specialist tools and confirmations from counterparties.

Gains and losses arising from changes in the fair value of the financial assets at fair value through profit or loss category are included in the profit or loss in the period in which they arise.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Financial Instruments (continued)

(ii) Financial assets held at amortised cost

Loans and advances to credit institutions. These are sums deposited in instantly accessible bank accounts with major high street banks, used for liquidity purposes.

Loans and advances to customers. These are sums advanced to the Group's borrowers, secured on property, land or (in a very restricted number of instances) unsecured. These include the NMB MAC and CLC portfolios, which have been categorised as purchased or originated credit – impaired ('POCI') financial assets and for which the original credit – adjusted effective interest rate is applied to the amortised cost of these financial assets, instead of the gross carrying amount.

The fair values of financial assets carried at amortised cost as at 31 December 2022 and 31 December 2021 are detailed in the fair values of financial assets and liabilities carried at amortised cost section on pages 42 and 43.

Purchases and sales of financial assets at fair value through profit or loss are recognised on the trade-date being the date on which the Group legally commits to purchase or sell the asset. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are no longer recognised when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

The Group and Society sets policy with regards to classification and measurement of financial instruments following consideration of its business model and whether cash flows are considered solely payments of principal and interest 'SPPI'. These are explained as follows:

Business model: the business model reflects how the Group manages the assets in order to generate cash flows. That is, whether the Group's objective is solely to collect the contractual cash flows from the assets or is to collect both the contractual cash flows and cash flows arising from the sale of assets. If neither of these is applicable (e.g. financial assets are held for trading purposes), then the financial assets are classified as part of 'other' business model and measured at FVPL. Factors considered by the Group in determining the business model for a Group of assets include past experience on how the cash flows for these assets were collected, how the asset's performance is evaluated and reported to key management personnel, how risks are assessed and managed and how managers are compensated.

SPPI: Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the Group assesses whether the financial instruments' cash flows represent solely payments of principal and interest (the 'SPPI test'). If the test is passed, the financial instruments are held at amortised cost. In making this assessment, the Group considers whether the contractual cash flows are consistent with a basic lending arrangement i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement. Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Impairment

The Group assesses on a forward-looking basis the expected credit losses ('ECL') associated with its debt instrument assets carried at amortised cost and FVOCI and with the exposure arising from loan commitments and financial guarantee contracts. The Group recognises a loss allowance for such losses at each reporting date. The measurement of ECL reflects:

- An unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
- The time value of money; and
- Reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Note 1b provides more detail of how the expected credit loss allowance is measured.

Investment in subsidiary undertaking

MBS (Mortgages) Limited is an entity over which the Group has control. The Group 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.

Investment in the Society's subsidiary undertaking relates to the share capital of the subsidiary and the remaining intraGroup loan advanced to the subsidiary and is recorded in the Statement of Financial Position at historic cost less any provision for impairment. Impairment of the intraGroup loan is assessed in line with the Group's impairment policy and compares the carrying value of the investment against future cash flows from the subsidiary undertaking.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Intangible assets

Intangible assets consist of externally acquired computer software, which are stated at cost less accumulated amortisation and impairment. In accordance with IAS 38 - Intangible Assets, software development costs are capitalised when it is probable that the asset created will generate future economic benefits for the Group. 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 which is estimated to be 5 years. Amortisation commences when the assets are ready for their intended use. Estimated useful lives are reviewed annually and adjusted, if appropriate, in response to technological developments, usage and other relevant factors.

Intangible assets are 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, based on value in use calculations

Property, plant and equipment

All property, plant and equipment is stated at historical cost less accumulated depreciation and any provision for impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the assets.

Subsequent costs are included in each asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the asset will flow to the Group and the cost of the asset can be measured reliably. All other repairs and maintenance expenses are charged to profit or loss during the financial year in which they are incurred.

Depreciation on assets is calculated using the straight-line method to allocate their cost less their residual values over their estimated useful lives, as follows:

- Office right-of-use assets: over 5 years.
- Fixtures and equipment: over 5 years.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each financial reporting date.

Non-current assets held for sale

At 31 December 2022 the Society has full ownership rights to a property that previously acted as collateral for a Spanish lifetime mortgage contract. .

As required under IFRS 5 — *Non-current Assets Held for Sale and Discontinued Operations*, this asset is available for immediate sale and management has assessed a sale within 12 months as highly probable. The asset is being actively marketed for sale at sales prices judged to be reasonable in relation to their fair values. The asset is held at the lower of its carrying amount and fair value less costs to sell.

Cash and cash equivalents

For the purposes of the statement of cash flows, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition including: cash in hand and non-restricted balances with central banks, loans and advances to banks and amounts due from other banks.

Corporation tax

Corporation tax is charged at the current rate calculated on the basis of the profit on ordinary activities as adjusted in line with HMRC requirements for taxation purposes.

Deferred tax

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 (and laws) that have been enacted or substantively enacted by the financial position date and are expected to apply when the deferred tax asset is realised or the liability is settled.

Deferred tax assets ("DTAs") are recognised only to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.

Pensions - Group defined contribution scheme

The Group operates a defined contribution pension scheme for its employees. All the costs incurred by the employer are included in profit or loss.

Foreign currency

Foreign currency transactions are translated into sterling, using the exchange rates prevailing at the dates of the transactions (spot exchange rate). Foreign exchange gains and losses resulting from the settlement of such transactions and from the re-measurement of monetary items at year-end exchange rates are recognised in the Statement of Comprehensive Income.

1. Accounting policies and financial risk management

a) Summary of significant accounting policies (continued)

Leases

Rental income and expenditure in relation to short-term leases (with no lease commitment in excess of 12 months) is recognised in profit or loss on a straight-line basis over the term of the lease in other income and charges in the Statement of Comprehensive Income.

For lease arrangements which are not classified as short-term, a lease liability is recorded at inception of each lease, based on the present value of the total lease payments due over the lease term, discounted using the rate implicit in the lease. The lease liability incurs interest expenditure at the rate implicit in the lease. A right-of-use asset is also recognised for such leases, initially measured as the present value of future lease payments due over the lease term plus initial direct costs incurred by the Group in relation to the lease set up. The rate implicit in the lease is used to derive the initial present value of the right-of-use asset. Depreciation is charged through the Statement of Comprehensive Income on a straight-line basis over the period covered by the lease agreement.

Financial Liabilities

All financial liabilities including shares, deposits, derivative financial instruments, debt securities and subordinated liabilities are recognised initially at fair value, being the issue proceeds, net of transaction costs incurred as appropriate. Financial liabilities, except for derivative financial instruments, are subsequently measured at amortised cost using the effective interest rate method. Following initial recognition derivative financial instruments continue to be recognised at fair value.

Offsetting

For the financial assets and liabilities subject to enforceable master netting arrangements or similar arrangements, each agreement between the Group and the counterparty allows for net settlement of the relevant financial assets and liabilities when both elect to settle on a net basis. In the absence of such an election, financial assets and liabilities will be settled on a gross basis. However, each party to the master netting agreement or similar agreement will have the option to settle all such amounts on a net basis in the event of default of the other party.

Provisions for liabilities and charges

A provision is recognised in the balance sheet if the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made.

Financial Services Compensation Scheme ("FSCS")

Previous claims were made on the FSCS following the failure of a number of financial institutions. In order to fund the claims made under its terms of operation, the FSCS has borrowed from the Bank of England and HM Treasury. The FSCS pays interest on its borrowings; it incurs operating expenses in its own right and incurs capital losses where shortfalls arise on the realisations of assets that it is managing from the failed. The costs of the FSCS are passed on to all UK banks and building societies.

No provision is required at 31 December 2022 as no shortfall exists within the scheme.

Customer redress provision

Provision for customer redress is made when the Group is aware of a specific historic conduct or regulatory issue and it is probable that customer remediation will be required to settle the obligation. Provision is made for the estimated cost of interest refunds, which is debited against interest income, and other associated costs which are debited against other administrative expenses.

Permanent Interest Bearing Shares

The Group has two tranches of Permanent Interest Bearing Shares in issue. Both sets were issued with the intention of enhancing the Group's regulatory capital position. The PIBS issued in 2005 confer unconditional discretion on the Group's Board to cancel in part or in whole any interest payment due. Interest on the 1999 PIBS can only be cancelled in a restricted number of circumstances; the Board does not have an unconditional right to cancel this interest. Therefore, in accordance with *IAS 32 - Financial Instruments: Presentation*, within the Financial Statements the 2005 PIBS are classified as equity and the 1999 PIBS are classified as a liability. Interest paid on the 1999 PIBS issue is shown in the Statement of Comprehensive Income whereas interest paid on the 2005 PIBS issue is shown in the Statement of Changes in Equity.

As a result of the shortfall against the qualitative standards for the level of CET 1 regulatory capital, in order to conserve capital under the applicable regulatory capital conservation rules, the Group did not pay coupons on PIBS between October 2016 and April 2021 inclusive. Following the increase in regulatory capital resulting from the profits generated in 2021, the qualitative standards of CET 1 capital were met from June 2021 and the coupons on both tranches of PIBS were paid in 2022. Whilst the Society continues to manage down the size of the balance sheet, there remains some uncertainty over the Society's ability to make PIBS coupon payments in the medium to long-term.

Profit Participating Deferred Shares

The Group has £18m of Profit Participating Deferred Shares ('PPDS'), issued during 2013 (see Note 26). These instruments qualify as equity within the Statement of Financial Position. Whilst no coupon has been paid on the PPDS, any such payments would be recorded through the Statement of Changes in Equity.

1. Accounting policies and financial risk management

b) Financial risk management

The following section discusses the Group's risk management policies. The measurement of ECL under IFRS 9 uses the information and approaches that the Group uses to manage credit risk, though certain adjustments are made in order to comply with the requirements of IFRS 9.

Strategy in using financial instruments

The Group accepts deposits from customers at both fixed and floating rates of interest, some of which are for fixed periods and others are open-ended; it seeks to enhance its interest margins by investing these funds in high-quality mortgages, liquidity instruments and liquid assets.

The Group has more fixed rate mortgages than fixed rate savings accounts. In order to manage the interest rate risk that arises, the Group may enter into simple-form interest rate swap arrangements with the intention of gaining some economic certainty as to its net interest margin position.

The Group uses financial instruments to invest liquid asset balances and to raise funding. The Group also uses derivative financial instruments to manage the risks arising from its operations.

The Board has authorised the use of derivatives by the Group to reduce the risk of loss arising from changes in market risks in accordance with Section 9A (4) of the Building Societies Act 1986 and derivatives are used by the Group for economic hedging purposes only. The Group does not run a trading book.

The principal derivatives used by the Group are foreign exchange contracts that are used to economically hedge Group Statement of Financial Position exposures. The Board does not intend to hedge its fixed rate mortgages using interest rate swaps at this time; this position is monitored regularly.

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Financial assets				
Loans and advances to credit institutions	5,016	10,589	5,015	10,588
Gross loans and advances - on residential property and land	110,845	133,744	99,529	122,086
Gross loans and advances - lifetime mortgages	44,470	42,611	44,470	42,611
Gross loans and advances - other loans	-	200	-	200
Loans to subsidiary undertakings	-	-	-	291
Derivatives - exchange rate swaps	12	712	12	712
	160,343	187,856	149,026	176,488

Impairment provisions are provided for expected credit losses in accordance with *IFRS 9 – Financial Instruments*. The figure for lifetime mortgages is stated after deduction of an effective interest rate provision.

Credit Risk

Credit risk is the risk of suffering financial loss, should any of the Group's customers, clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk arises mainly from interbank, commercial and consumer loans and advances, and loan commitments arising from such lending activities.

The Group is also exposed to other credit risks arising from its trading activities ('trading exposures') including derivatives and settlement balances with market counterparties. Credit risk is the single largest risk for the Group's business; management therefore carefully manages its exposure to credit risk. The credit risk management and control are centralised in a credit risk management group which reports regularly to the Credit Committee and Executive Committee.

Credit risk - forbearance

The Group's forbearance strategy is to seek to agree with borrowers in financial difficulty the provision of short to medium-term assistance with their monthly mortgage payments, in order to avoid or mitigate the risk of financial loss. The range of forbearance options available in certain circumstances includes arrangements to clear the arrears over a reasonable period of time, payment concessions, and capitalisation of arrears. For mortgages that are not past due, conversion to interest only payment terms, an extension of term, or suspension of monthly payments pending sale of the property are available as options to reduce the monthly payment due and these seek to avoid a mortgage entering arrears and becoming past due, allowing time for a borrower to regularise their financial position.

As at 31 December 2022, the Group had 26 accounts (2021: 29) with balances of £3.3m (2021: £3.7m) where conversion to interest only or an extension of term had taken place. Of these, 3 accounts (2021: 6) were neither past due or impaired, and 23 (2021: 23) were past due and/or impaired with an aggregate capital balance of £3.2m (2021: £3.5m); aggregate arrears of £24k (2021: £11k); and aggregate impairment provision of £95k (2021: £166k).

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Credit risk – forbearance (continued)

The forbearance strategy seeks to avoid arrears arising or further increasing and to allow account performance to be restored by supporting the mortgage payments being brought up to date or to provide a period of time for repayment of the amount owed. The assessment of impaired loans incorporates management work-out strategies in relation to a number of credit exposures. If expectations were to change then this would affect the impairment risk. The Group's implementation of IFRS 9 impairment specifically categorises long-term forborne loans as stage 3 (credit impaired), and therefore in default for provisioning purposes.

There are no specific concentrations of accounts in forbearance in relation to portfolios or geographical areas.

Credit risk – Loans and advances to customers

The analysis shown below, in relation to loans and advances to customers is based on the Group's balances. Information is disclosed for the Society where there is significant variance between the Group and Society figures.

- Of the £155.3m of gross assets in this class £144.1m (92.8%) (2021: 92.1%) is fully secured on residential property, £11.1m (7.1%) (2021: 7.7%) is fully secured on land and £0.1m (0.1%) (2021: 0.1%) relates to unsecured personal loans.
- With gross balances of £44.5m, lifetime mortgages represent 28.7% of this class (2021: 24.1%).

Secured lending – fully secured on residential property

The average loan to valuation ("LTV") of the Group's lending that is secured on residential property is estimated at 41% (2021: 44%). Further analysis of the Group's residential property lending is detailed below.

	2022 %	2021 %
<70%	66	68
70% - 80%	4	3
80% - 90%	6	4
90% - 100%	3	5
>100%	21	20
Average loan to value of stock - UK mortgages	27	29
Average loan to value of stock - Spanish mortgages	108	118

Estimates of current LTV are obtained by indexing the valuation at the last physical inspection of the property, by reference to externally published data. At 31 December 2022, 34% of the loan book had an LTV of 70% or greater (2021: 32%). In the event that valuations were to increase by 5%, at 31 December 2022 this would reduce the proportion of the loan book that had an LTV of 70% or greater to 31% (2021: 30%); in the event that House Price Indices ("HPIs") decreased by 5% at 31 December 2022, the proportion of the loan book with an LTV of 70% or greater would increase to 35% (2021: 34%). The LTV of the Spanish lifetime mortgages is expected to continue to increase as interest income accrues.

The Group continues to review regularly the quality of its loans that are fully secured on residential property. The proportion of these loans more than 3 months in arrears is 6.2% (2021: 4.2%). There are 36 Spanish lifetime mortgages (2021: 32) and 2 UK lifetime mortgages (2021: nil) where an event has occurred which under the terms of the mortgage means a repayment is now due.

The table below provides further information on the payment due status of gross loans fully secured on residential property.

	2022 £m	2022 %	2021 £m	2021 %
Not past due and up to 3 months	124.3	86	144.7	88
Past due 3 to 6 months	2.9	2	0.9	1
Past due 6 to 12 months	1.7	1	1.3	1
Past due over 12 months	3.4	2	2.8	2
Possessions *	1.0	1	1.8	1
	133.3	92	151.5	93
NMB MAC mortgage book **	9.9	7	10.2	6
CLC mortgage book **	0.9	1	1.0	1
	144.1	100	162.7	100

* For properties in possession, £1.1m (2021: £2.0m) of collateral is held. In the analysis above, for all past due loans, £28.0m (2021: £28.0m) of collateral is held.

** The NMB MAC and CLC mortgage books of second charge loans were initially acquired at a deep discount and are considered impaired. Arrears banding information is not presented for these portfolios as there is insufficient reliable data to determine this accurately. The net book value of these loan books after impairment provisions is £1.6m (2021: £2.0m).

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Geographical Analysis

The table below provides information on the geographical split of the Group's gross lending on residential property:

	2022 £m	2022 %	2021 £m	2021 %
East Midlands	1.6	1	2.2	1
Greater London	6.8	5	7.8	5
London	17.5	12	19.8	12
North	2.5	2	3.2	2
North West	43.2	29	53.1	31
Other	5.7	4	6.1	4
South East	9.0	6	10.9	7
South West	2.8	2	3.2	2
Wales	2.2	2	3.3	2
West Midlands	3.7	3	4.4	3
Yorkshire	4.6	3	5.9	4
Total UK properties	99.6	69	119.9	73
Spain (lifetime mortgages)	44.5	31	42.8	27
	144.1	100	162.7	100

Secured lending – fully secured on land

The constitution of gross loans secured on land by industry type is as follows:

	2022 £m	2022 %	2021 £m	2021 %
Offices	4.7	42	5.0	36
Shops	3.5	31	3.8	28
Industrial	1.4	13	1.6	12
Restaurants, Hotels and other	1.5	14	3.3	24
	11.1	100	13.7	100

The table below provides further information on the payment due status of gross loans that are fully secured on land:

	2022 £m	2022 %	2021 £m	2021 %
Not past due and up to 3 months	10.0	90	11.6	84
Past due 3 to 6 months	1.0	9	0.4	3
Past due 6 to 12 months	0.1	1	0.1	1
Past due over 12 months	-	-	1.6	12
Possessions *	-	-	-	-
	11.1	100	13.7	100

* No collateral is held for properties in possession (2021: £nil). In the analysis above, for all past due loans, £3.6m of collateral is held (2021: £2.5m).

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Unsecured lending

The table below provides further information on the payment due status of gross unsecured loans:

	2022 £m	2022 %	2021 £m	2021 %
Not past due and up to 3 months	0.1	100	0.2	100
Past due 3 to 6 months	-	-	-	-
Past due 6 to 12 months	-	-	-	-
Past due over 12 months	-	-	-	-
	0.1	100	0.2	100

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

Credit risk relating to liquid assets arises from the investments held by the Group in order to meet business-as-usual liquidity requirements. This aspect of credit risk is managed by the Group's Risk Committee, which sets and monitors compliance with policy and limits. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

The maximum individual counterparty exposure at the financial position date was £38m (2021: £38m) which was on deposit with the Bank of England. The number of active counterparties at the financial position date was 4 (2021: 4). All counterparties are UK domiciled banks whose registered address is within the UK and who are authorised by the PRA and regulated by the FCA and PRA as lead regulators; this is in support of the Board's low risk appetite approach to banking counterparty risk. As at 31 December 2022, all counterparties were at least "A-" rated by Moody's.

For credit purposes, the liquid asset portfolio comprises the following sub-portfolios as at 31 December:

	2022 £m	2022 %	2021 £m	2021 %
UK Financial institutions	43.2	100	48.3	100
	43.2	100	48.3	100

The Group's Risk Committee monitors exposure concentrations against a variety of criteria including industry sector / asset class and country of counterparty.

	2022 £m	2022 %	2021 £m	2021 %
UK	43.2	100	48.3	100
	43.2	100	48.3	100

Geographical exposure, assessed by reference to the registered address of the counterparty and the lead regulator of the entity, is solely within the UK.

Industry sector/asset class exposure:

	2022 £m	2022 %	2021 £m	2021 %
UK Financial institutions	43.2	100	48.3	100
	43.2	100	48.3	100

Collateral held as security for liquid assets is determined by the nature of the instrument. Loans and debt securities are generally unsecured with the exception of asset backed securities which are secured by pools of financial assets.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Credit risk – foreign exchange derivatives and offsetting

Foreign exchange derivative financial assets are subject to offsetting, enforceable, master netting agreements. The gross amounts of these assets on the balance sheet are £12k (2021: £712k). Related amounts not set off are £956k (2021: £9k) financial liabilities with £nil cash collateral received (2021: £220k).

Foreign exchange derivative financial liabilities are subject to offsetting, enforceable, master netting agreements. The gross amounts of these liabilities on the balance sheet are £956k (2021: £9k). Related amounts not set off are £12k (2021: £712k) financial assets with cash collateral deposited of £2,150k (2021: £1,110k).

Credit risk – Expected credit loss measurement

Under IFRS 9, impairment is based on expected credit losses ("ECL").

ECL is calculated as the product of Probability of Default, Exposure at Default and Loss Given Default for each account, which are defined as:

- Probability of Default ("PD") is an estimate of the likelihood of the account defaulting over either 12 months (Stage 1) or the lifetime of the account (Stage 2)
- Exposure at Default ("EAD") is the expected balance sheet exposure at the time of default taking into account all expected changes over the lifetime of the account. This includes capitalisation of interest, repayments and the impact of forward-looking economic estimates
- Loss Given Default ("LGD") is the amount of loss that will be incurred in the event of default incorporating the impact of forward-looking economic estimates

The ECL impairment provisioning under IFRS 9 includes the requirement to include forward looking information in order to establish expected credit losses, and also to consider multiple economic scenarios.

At initial recognition, an ECL provision is required for default events in the next 12 months, whilst following a significant increase in credit risk, a lifetime ECL is required. The review of credit risk and the calculation of ECL are required to be unbiased and probability weighted, and should include all available relevant information, with assessments of current conditions and forecasts of future economic conditions.

The Group is required to perform a staging assessment of each financial instrument. The three stages are as follows:

- Stage 1: Loans where there has been no significant deterioration in credit risk since initial recognition of the loan by the Society
- Stage 2: Loans where there has been a significant increase in credit risk since initial recognition of the loan by the Society
- Stage 3: Loans which are deemed to be "credit impaired" (and therefore in default)

Significant increase in credit risk

A significant increase in credit risk is not a defined term, and is determined by Management, based on their experience and judgment. In assessing whether the credit risk has significantly increased the Group has identified a series of quantitative, qualitative and backstop criteria (30 days past due as set by IFRS 9) which take into account forward-looking macroeconomic factors. These are referred to as the staging criteria.

The staging criteria have been extensively tested to ensure the characteristics of the portfolio are correctly reflected and accounts appropriately flow through the stages prior to default. The Group has considered how long is a suitable period after a loan no longer falls within an arrears category before it is appropriate to consider that the loan has "cured" and can have its credit risk status upgraded. A cure period of six months has been deemed appropriate for Stage 2. This means that an account remains in stage 2 for a period of six months after it ceases to meet any stage 2 criteria.

The staging criteria take into account the following:

- Quantitative criteria – if an account's current lifetime PD is greater than a fourfold increase of origination lifetime PD then the credit risk of the account is considered to have increased significantly;
- Qualitative criteria – if an account enters forbearance or demonstrates other indicators of financial difficulty, not yet caught by an increase in PD, then the credit risk of the account is considered to have increased significantly; and
- Backstop – if the account is 30 days past due it will automatically transition to Stage 2.

The staging criteria are monitored and revisited in advance of each reporting date.

The Group has not used the low credit risk exemption for any financial instruments in the years ended 31 December 2022 and 31 December 2021.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Significant increase in credit risk (continued)

Definition of default

The definition of default is used to determine both the PD and the transition to stage 3 (all accounts which have defaulted are recognised in stage 3).

The Group defines a financial instrument as in default, when it meets one or more of the following criteria:

Quantitative criteria

The borrower is more than 90 days past due on its contractual payments or if the loan maturity date has passed.

Qualitative criteria

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where:

- The borrower is in long-term forbearance
- The borrower is deceased
- The borrower is insolvent
- Concessions have been made by the lender relating to the borrower's financial difficulty
- The borrower has entered bankruptcy
- The borrower is subject to a lasting power of attorney
- The collateral has been repossessed or surrendered
- The borrower is subject to litigation
- The borrower is subject to a debt management agreement
- Financial assets are purchased or originated at a deep discount that reflects the incurred credit losses

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to model the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) throughout the Group's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a consecutive period of 12 months. This period of 12 months has been determined based on an analysis which considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions.

Measuring ECL – Explanation of inputs, assumptions and estimation techniques

The Expected Credit Loss (ECL) is measured on either a 12 month or Lifetime basis depending on whether a significant increase in credit risk has occurred since initial recognition or whether an asset is considered to be credit-impaired. Expected credit losses are the discounted product of the Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD), defined as follows:

Probability of default (PD)

PD is a key component in the calculation of ECL and the transition from stage 1 to stage 2. It is an estimate of the likelihood of default over either 12 months or the lifetime of the account. Management have used historical data, assumptions and expectations of future conditions to model PD over time. An origination PD is required for each account. Where origination PDs were not available at the origination date, the origination PD was approximated, based on available account level data.

Exposure at default (EAD)

EAD is the amount that the Group expects the exposure to be at the point of default based on the contractual payment profile, historic behaviours and the impact of applying forward-looking economic estimates.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Loss given default (LGD)

LGD is the amount of loss that will be incurred in the event of default. It represents the actual cash flows expected to be recovered for an individual account, and takes in to account collateral values and other cash recovered e.g. rental income due on properties in possession.

The ECL is determined by projecting the PD, LGD and EAD for each individual exposure or collective segment. These three components are multiplied together and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted back to the reporting date and summed. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The Lifetime PD is developed by applying a maturity profile to the current 12-month PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis.

The 12 month and lifetime EADs are determined based on the contractual repayments owed by the borrower over a 12 month or lifetime basis.

The 12 month and lifetime LGDs are determined based on the factors which impact the recoveries made post default. This is primarily based on collateral type and projected collateral values, historical discounts to market/book values due to forced sales, time to repossession and recovery costs observed.

Expected life

The calculation of ECL is over the expected life of the account. Where an account is past its contractual term it will be treated as being impaired (in default) and the loss calculated as at that point, assigning a PD = 1 and remaining term = 0.

Origination dates

The origination date of an exposure is the contractual origination date. The origination date is when the origination PD is determined, which will be referenced at each reporting period when determining if there has been a significant increase in credit risk.

Forward-looking economic information is also included in determining the 12 month and lifetime PD, EAD and LGD.

Forward looking information included in the ECL models

Unbiased macro-economic scenarios covering multiple potential outcomes are required by IFRS 9 to be incorporated into the ECL calculation.

The macro-economic variables with the most significant impact on PD and LGD, for the Group, are judged to be house price inflation; UK unemployment rate; consumer price index and bank base rate.

The Group has determined an approach to the selection and application of multiple scenarios. The Group does not have an in-house economics function and has therefore sourced complete economic scenarios from a third party. These scenarios are supported by director review and approval of appropriateness of assumptions.

The Group considers four scenarios on a probability-weighted approach. These scenarios include a base, an upturn, a mild downturn and a severe downturn scenario. The combination of the four scenarios provides an unbiased but representative macro view of possible future outcomes capturing any non-linearity's of account behaviour. At 31 December 2022, weightings applied 39% to the base, 30% to the upturn, 30% to the mild downturn and 1% to the severe downturn. These weightings are unchanged from 2021.

As with any economic forecasts, the projections and likelihoods of occurrence are subject to a high degree of inherent uncertainty and therefore the actual outcomes may be significantly different to those projected. The Group considers these forecasts to represent its best estimate of the possible outcomes based on reliable available information.

Economic forecasts are produced every three months for base, upturn and mild downturn; and every six months for the severe downturn.

The consequences of climate change, and in particular the impact of flooding, have been considered and no material impact has been identified on the properties held as collateral against loans. There is not, therefore, expected to be an impact upon the ECL.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Forward looking information included in the ECL models (continued)

The macro-economic assumptions adopted in the latest ECL calculation of each scenario are:

	2022				2021			
	Upturn	Base	Mild Downturn	Severe Downturn	Upturn	Base	Mild Downturn	Severe Downturn
House price index (5 year average)	1.9%	0.4%	(2.6%)	(6.3%)	4.0%	1.4%	(3.2%)	(9.4%)
Consumer price index (5 year average)	2.4%	2.0%	1.4%	0.8%	2.3%	2.0%	1.5%	1.0%
UK Unemployment rate (5 year average)	3.9%	4.1%	6.3%	7.0%	3.6%	3.9%	6.0%	6.6%
Bank base rate (5 year average)	3.7%	2.7%	2.3%	1.2%	1.5%	0.8%	0.3%	(0.4%)

Sensitivity Analysis

The most significant assumptions affecting the ECL allowance are as follows:

- **The weighting given to the economic scenarios used within the ECL calculation**

  The Group have considered four scenarios when calculating a weighted ECL with weightings based upon expert judgment. The table below sets out the ECL of each scenario prior to weighting based upon current staging:

	2022					2021				
	Upturn £000	Base £000	Mild Downturn £000	Severe Downturn £000	Blended ECL £000	Upturn £000	Base £000	Mild Downturn £000	Severe Downturn £000	Blended ECL £000
Weighting	30%	39%	30%	1%		30%	39%	30%	1%	
ECL (100% weighting)	11,313	11,496	12,369	13,513	11,723	12,244	12,752	13,939	15,956	12,988

- **House price index**

  If the value of current house prices were 5% higher than that currently estimated, then the total impairment provision required for the Group would decrease from £23.3m to £22.3m. If current prices were 5% lower, then the provision requirement would increase by £0.9m to £24.2m.

- **The value of cash receipts within the NMB MAC and CLC portfolios**

  The recoverability of loan balances has been included in the estimate of discounted future cash flows that forms the basis of the impairment provision. This has been assessed based on recent historic cash flow receipts, experience of redemptions and using estimates of the likely future redemption dates.

  The value of the mortgage assets, post impairment provision in these two portfolios, is £1.6m (2021: £2.0m) of which 58% (2020: 54%) relates to MCOB regulated mortgages.

  A 5% uplift in cash flows from the mortgage assets in these NMB MAC and CLC portfolios, associated with greater levels of recoverability than currently estimated, would result in the provision being reduced from £9.2m to £9.1m whilst a 10% reduction in cash flows would see the provision requirement increase from £9.2m to £9.4m.

  16 suspended possession orders are held against properties and following legal advice the directors believe that these orders remain valid and would result in recoveries. A risk exists that a court may not give leave to enforce the order and that alternative recovery action would need to be undertaken. If recovery as a result of such orders was not possible in all cases, the increase to the provision held at 31 December 2022 would be £0.2m.

The Board monitors its credit risk exposures, underlying security values and the level of impairment provisions on a regular basis.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Cash flow and fair value interest rate risk

Cash flow interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce or create losses in the event that unexpected movements arise. The Board sets limits on the level of mismatch of interest rate repricing that may be undertaken, which are monitored monthly.

The table below summarises the Group's exposure to interest rate risks. Included in the table are the Group's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

The Group's interest rate sensitivity exposure at 31 December 2022 and 31 December 2021 was:

	0-3 months £000	3-6 months £000	6-12 months £000	1-5 years £000	5-10 years £000	10-20 years £000	20-30 years £000	Over 30 years £000	Non-interest bearing £000	Total £000
At 31 December 2022										
Assets										
Cash and central banks balances	38,161	-	-	-	-	-	-	-	62	38,223
Due from other banks	4,993	-	-	-	-	-	-	-	23	5,016
Loans to customers	94,729	116	324	1,410	818	1,523	200	-	-	99,120
Lifetime mortgages	-	-	1,632	7,847	8,001	14,808	635	-	-	32,923
Derivatives	10	2	-	-	-	-	-	-	-	12
Other assets	2,150	-	-	-	-	-	-	-	825	2,975
Total assets	140,043	118	1,956	9,257	8,819	16,331	835	-	910	178,269
Liabilities										
Other deposits	6,173	-	-	-	-	-	-	-	22	6,195
Due to members	123,645	4,003	1,501	-	-	-	-	-	240	129,389
Subordinated liabilities	-	-	-	-	-	-	-	-	-	-
Derivatives	426	384	146	-	-	-	-	-	-	956
Other liabilities	-	-	-	-	-	-	-	-	1,012	1,012
Subscribed capital	-	-	-	-	-	-	-	-	14,788	14,788
Profit participating deferred shares	-	-	-	-	-	-	-	-	17,461	17,461
Accumulated profits	-	-	-	-	-	-	-	-	8,468	8,468
Total liabilities	130,244	4,387	1,647	-	-	-	-	-	41,991	178,269
Interest rate sensitivity gap	9,799	(4,269)	309	9,257	8,819	16,331	835	-	(41,081)	-
Cumulative gap	9,799	5,530	5,839	15,096	23,915	40,246	41,081	41,081	-	-

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Cash flow and fair value interest rate risk (continued)

	0-3 months £000	3-6 months £000	6-12 months £000	1-5 years £000	5-10 years £000	10-20 years £000	20-30 years £000	Over 30 years £000	Non-interest bearing £000	Total £000
At 31 December 2021										
Assets										
Cash and central banks balances	37,700	-	-	-	-	-	-	-	4	37,704
Due from other banks	10,589	-	-	-	-	-	-	-	-	10,589
Investment securities	-	-	-	-	-	-	-	-	-	-
Loans to customers	115,556	155	327	1,543	946	2,238	191	-	-	120,956
Lifetime mortgages	-	-	771	6,426	5,287	18,459	1,401	-	-	32,344
Derivatives	428	187	97	-	-	-	-	-	-	712
Other assets	1,110	-	-	-	-	-	-	-	1,191	2,301
Total assets	165,383	342	1,195	7,969	6,233	20,697	1,592	-	1,195	204,606
Liabilities										
Other deposits	7,032	-	-	-	-	-	-	-	4	7,036
Due to members	143,185	5,208	1,824	-	-	-	-	-	37	150,254
Subordinated liabilities	-	-	-	-	5,000	-	-	-	-	5,000
Derivative financial instruments	4	-	5	-	-	-	-	-	-	9
Other liabilities	220	-	-	-	-	-	-	-	1,753	1,973
Subscribed capital	-	-	-	-	-	-	-	-	14,788	14,788
Profit participating deferred shares	-	-	-	-	-	-	-	-	17,461	17,461
Accumulated losses	-	-	-	-	-	-	-	-	8,085	8,085
Total liabilities	150,441	5,208	1,829	-	5,000	-	-	-	42,128	204,606
Interest rate sensitivity gap	14,942	(4,866)	(634)	7,969	1,233	20,697	1,592	-	(40,933)	-
Cumulative gap	14,942	10,076	9,442	17,411	18,644	39,341	40,933	40,933	-	-

The Group's financial performance is sensitive to changes in interest rates in respect of the interest it earns. Based on the assets and liabilities in the balance sheet at 31 December 2022 an increase of 1% in market interest rates across all maturities would reduce income and equity by £2.0m (2021: £3.0m reduction). These amounts are for indication only, and represent the impact of an unexpected overnight 1% parallel shift in the yield curve, without any subsequent management action, and consequently do not represent amounts that are at risk. ALCO monitor a variety of interest rate shocks from 0.5% to 2%.

Liquidity risk

The Group is exposed to daily calls on its available cash resources from customer withdrawals, maturing deposits, loan draw-downs and guarantees, and from margin and other calls on cash-settled derivatives. The Group does not maintain immediately available cash resources to meet instantly all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty.

The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the nature of the funds that are available to the Group on an instantly accessible basis; with the latter, the Board strategy has been to place notable sums with the Bank of England and with other UK "High Street" banks in order to ensure that it meets its objectives of ensuring that all such funds are highly liquid.

The liquidity profile throughout 2022 has aligned with the Board's low risk appetite in this area and day-to-day operations of the liquidity portfolio saw compliance with all policy limits throughout the period. Such policy limits are reviewed on a daily basis and it should be noted that the Group has consistently maintained cash resources in excess of the policy minimum.

The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

The Group has continued to hold liquidity levels well in excess of the regulatory thresholds during the year. This has contributed to downward pressure on net interest income.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Liquidity risk (continued)

The table below analyses the Group's contractual cash flows under financial liabilities.

	On demand £000	0-3 months £000	3-12 months £000	1-5 years £000	5-10 years £000	10-15 years £000	Over 15 years £000	Total £000
At 31 December 2022								
Due to members	41,870	62,980	24,539	-	-	-	-	129,389
Due to other banks and depositors	3,891	2,304	-	-	-	-	-	6,195
Derivative financial instruments	-	426	530	-	-	-	-	956
Other liabilities	793	116	65	38	-	-	-	1,012
PIBS interest	-	-	400	1,600	2,000	2,000	2,000	8,000
Subordinated liabilities	-	-	-	-	-	-	-	-
Total outflow	46,554	65,826	25,534	1,638	2,000	2,000	2,000	145,552
	£000	£000	£000	£000	£000	£000	£000	£000
At 31 December 2021								
Due to members	46,364	71,511	32,379	-	-	-	-	150,254
Due to other banks and depositors	4,423	2,613	-	-	-	-	-	7,036
Derivative financial instruments	-	4	5	-	-	-	-	9
Other liabilities	907	796	60	124	-	-	-	1,887
PIBS interest	-	-	400	1,600	2,000	2,000	2,000	8,000
Subordinated liabilities	-	84	251	1,340	1,675	5,270	-	8,620
Total outflow	51,694	75,008	33,095	3,064	3,675	7,270	2,000	175,806

The table below analyses the Group's assets and liabilities into relevant maturity Groupings based on the remaining period at the financial position date to the contractual maturity date. The equivalent information has not been disclosed for the Society as there is no significant variance between the Group and Society figures.

	0-3 months £000	3-6 months £000	6-12 months £000	1-5 years £000	5-10 years £000	10-20 years £000	20-30 years £000	Over 30 years £000	Total £000
At 31 December 2022									
Assets									
Cash and central banks balances	38,223	-	-	-	-	-	-	-	38,223
Due from other banks	5,016	-	-	-	-	-	-	-	5,016
Derivative financial instruments	10	2	-	-	-	-	-	-	12
Loans to customers	10,618	2,703	3,601	37,912	38,711	5,245	18	312	99,120
Lifetime mortgages	-	-	3,828	12,971	9,121	6,879	124	-	32,923
Other assets	353	401	2,045	176	-	-	-	-	2,975
Total assets	54,220	3,106	9,474	51,059	47,832	12,124	142	312	178,269
Liabilities									
Other deposits	6,195	-	-	-	-	-	-	-	6,195
Derivative financial instruments	426	384	146	-	-	-	-	-	956
Due to members	104,850	23,032	1,507	-	-	-	-	-	129,389
Subordinated liabilities	-	-	-	-	-	-	-	-	-
Other liabilities	909	21	44	38	-	-	-	-	1,012
Total liabilities	112,380	23,437	1,697	38	-	-	-	-	137,552
Net liquidity gap	(58,160)	(20,331)	7,777	51,021	47,832	12,124	142	312	40,717
At 31 December 2021									
Total assets	60,272	2,854	9,590	47,079	49,873	34,061	545	333	204,606
Total liabilities	126,703	30,574	1,871	124	-	5,000	-	-	164,272
Net liquidity gap	(66,431)	(27,720)	7,719	46,955	49,873	29,061	545	333	40,334

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Liquidity risk (continued)

The matching and controlled mismatching of the maturities and interest rates of assets and liabilities is fundamental to the management of the Group. The Group does not expect the maturities and interest rates to be completely matched, as transacted business is often of uncertain term and of different types. An unmatched position potentially enhances profitability but could also increase the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Group and its exposure to changes in interest rates and exchange rates.

Currency risk

At 31 December 2022 the Group had a foreign currency exposure of €51.8m (2021: €54.6m) in loans and receivables. At the balance sheet date this exposure is economically hedged with short term foreign exchange forward contracts. The Board sets limits on the level of exposures to foreign currency and these are monitored daily.

Foreign Exchange Sensitivity

The Group has assessed, on an indicative basis, the effect that a movement in the GBP/Euro exchange rate from €1.13 to €1.23 on the Group's income, as a result of a revaluation of the balance sheet assets and liabilities.

	2022 £000	2021 £000
Effect on income with no Euro forward contracts	(2,801)	(2,668)
Effect on income with Euro forward contracts	67	19

The Group matches the foreign exchange exposure against Euro assets net of provisions.

Classification of financial assets and liabilities

The following tables show the classification of the Group's and Society's financial assets and liabilities

	Group as at 31 December 2022			Society as at 31 December 2022		
	Financial assets and liabilities held at amortised cost £000	Fair value through profit or loss £000	Total £000	Financial assets and liabilities held at amortised cost £000	Fair value through profit or loss £000	Total £000
Assets						
Cash and balances with central banks	38,223	-	38,223	38,223	-	38,223
Loans and advances to credit institutions	5,016	-	5,016	5,015	-	5,015
Derivative financial instruments	-	12	12	-	12	12
Loans and advances to customers	132,043	-	132,043	129,304	-	129,304
Investments	-	-	-	1	-	1
Other assets	1,389	-	1,389	1,389	-	1,389
	176,671	12	176,683	173,932	12	173,944
Non-financial assets			1,586			1,586
Total assets			178,269			175,530
Liabilities						
Due to members	129,389	-	129,389	129,389	-	129,389
Other deposits	6,195	-	6,195	6,195	-	6,195
Derivative financial instruments	-	956	956	-	956	956
Other liabilities	917	-	917	1,031	-	1,031
Subordinated liabilities	-	-	-	-	-	-
Subscribed capital	5,000	-	5,000	5,000	-	5,000
	141,501	956	142,457	141,615	956	142,571
Non-financial liabilities			35,812			32,959
			178,269			175,530

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Classification of financial assets and liabilities (continued)

	Group as at 31 December 2021			Society as at 31 December 2021		
	Financial assets and liabilities held at amortised cost	Fair value through profit or loss	Total	Financial assets and liabilities held at amortised cost	Fair value through profit or loss	Total
	£000	£000	£000	£000	£000	£000
Assets						
Cash and balances with central banks	37,704	-	37,704	37,704	-	37,704
Loans and advances to credit institutions	10,589	-	10,589	10,588	-	10,588
Derivative financial instruments	-	712	712	-	712	712
Loans and advances to customers	153,300	-	153,300	150,234	-	150,234
Investments	-	-	-	292	-	292
Other assets	324	-	324	324	-	324
	201,917	712	202,629	199,142	712	199,854
Non-financial assets			1,977			1,977
Total assets			204,606			201,831
Liabilities						
Due to members	150,254	-	150,254	150,254	-	150,254
Other deposits	7,036	-	7,036	7,036	-	7,036
Derivative financial instruments	-	9	9	-	9	9
Other liabilities	1,882	-	1,882	1,874	-	1,874
Subordinated liabilities	5,000	-	5,000	5,000	-	5,000
Subscribed capital	5,000	-	5,000	5,000	-	5,000
	169,172	9	169,181	169,164	9	169,173
Non-financial liabilities			35,425			32,658
Total liabilities			204,606			201,831

Fair value of financial assets and liabilities carried at amortised cost

The tables below show the book value and fair value of the Group's and Society's financial assets and liabilities held at amortised cost in the Statement of Financial Position.

Group	2022 Carrying value	2022 Fair value	2021 Carrying value	2021 Fair value
	£000	£000	£000	£000
Financial assets				
Cash and balances with the Bank of England	38,223	38,223	37,704	37,704
Loans and advances to credit institutions	5,016	5,016	10,589	10,589
Loans and advances to customers	132,043	128,342	153,300	145,618
Other assets	1,389	1,389	324	324
	176,671	172,970	201,917	194,235
	£000	£000	£000	£000
Financial liabilities				
Due to members	129,389	129,366	150,254	150,248
Other deposits	6,195	6,195	7,036	7,036
Subordinated liabilities	-	-	5,000	5,000
Subscribed capital	5,000	5,381	5,000	5,238
Other liabilities	916	916	1,195	1,195
	141,500	141,858	168,485	168,717

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Fair value of financial assets and liabilities carried at amortised cost (continued)

Society	**2022 Carrying value £000**	**2022 Fair value £000**	**2021 Carrying value £000**	**2021 Fair value £000**
Financial assets				
Cash and balances with the Bank of England	38,223	38,223	37,704	37,704
Loans and advances to credit institutions	5,015	5,015	10,588	10,588
Loans and advances to customers	129,304	125,603	150,234	142,552
Other assets	1,389	1,389	324	324
	173,931	170,230	198,850	191,168
	£000	**£000**	**£000**	**£000**
Financial liabilities				
Due to members	129,389	129,366	150,254	150,248
Other deposits	6,195	6,195	7,036	7,036
Subordinated liabilities	-	-	5,000	5,000
Subscribed capital	5,000	5,381	5,000	5,238
Other liabilities	911	911	1,187	1,187
	141,495	141,853	168,477	168,709

i. Cash and balances with the Bank of England – the fair value is the same as the carrying value as the amounts are repayable on demand.
ii. Loans and advances to credit institutions – the fair value of overnight deposits is the same as the carrying value as the amounts are repayable on demand. The estimated fair value of loans and advances to credit institutions is calculated based upon discounted expected future cash flows.
iii. Loans and advances to customers – the estimated fair value of loans and advances to customers represents the discounted amount of estimated future cash flows expected to be received after taking into account impairment and expected prepayment rates. Estimated cash flows are discounted using prevailing markets rates for items of similar maturity.
iv. Shares and borrowings – The estimated fair value of deposits with no stated maturity is the amount repayable on demand. The estimated fair value of fixed interest bearing deposits and other borrowings without quoted market prices is based on discounted cash flows using interest rates for new deposits with similar remaining maturity.

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between knowledgeable, willing market participants at the measurement date.

Wherever possible, fair values have been calculated using unadjusted quoted market prices in active markets for identical instruments held by the Group. Where quoted market prices are not available, or are unreliable, fair values have been determined using valuation techniques which, to the extent possible, use market observable inputs, but in some cases use non-market observable inputs.

Valuation techniques used include discounted cash flow analysis and pricing models and, where appropriate, comparison to instruments with characteristics similar to those of the instruments held by the Group.

Because a variety of estimation techniques are employed and significant estimates made, comparisons of fair values between financial institutions may not be meaningful. Readers of these financial statements are thus advised to use caution when using this data to evaluate the Group's financial position.

The fair value measurement basis used is as follows:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 Valuation techniques where all inputs are taken from observable market data, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 Valuation techniques where significant inputs are not based on observable market data. None of the Group's assets or liabilities are valued using this technique.

1. Accounting policies and financial risk management

b) Financial risk management (continued)

Fair values of assets and liabilities held at fair value

The table below shows the fair values of the Group's assets and liabilities held at fair value in the Statement of Financial Position analysed according to the hierarchy described above:

Fair value of assets and liabilities carried at fair value

Group	2022 Level 1 £000	2022 Level 2 £000	2022 Total £000
Financial assets			
Derivative financial instruments	-	12	12
	-	12	12
Financial liabilities			
Derivative financial instruments	-	956	956
	-	956	956

Group	2021 Level 1 £000	2021 Level 2 £000	2021 Total £000
Financial assets			
Derivative financial instruments	-	712	712
	-	712	712
Financial liabilities			
Derivative financial instruments	-	9	9
	-	9	9

(i) Market prices have been used to determine the fair value of listed investment securities

(ii) The fair value of derivatives that are not listed are calculated by utilising internal valuation models using a discounted cash flow model based on a current yield curve appropriate for the remaining term to maturity. External market data is used within these internal valuation models. Derivatives are held for trading. Movements in the valuations of derivatives are treated as fair value through profit and loss, and these financial assets and liabilities are Grouped into the fair value hierarchy under level 2.

(iii) The fair value of Investment Properties is determined by using available index data and reflects the market value at the balance sheet date and revaluations performed in the year.

1. Accounting policies and financial risk management

c) Critical accounting estimates and judgments in applying accounting policies

The preparation of financial statements requires the use of accounting estimates which, by definition, will seldom equal the actual results. Management also needs to exercise judgment in applying the Group's accounting policies.

This note provides an overview of the areas that involve a higher degree of judgment or complexity, and major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment within the next financial year. Detailed information about each of these estimates and judgments is included in the related notes together with information about the basis of calculation for each affected line item in the financial statements.

(i) Measurement of the expected credit loss allowance (IFRS 9)

The measurement of the expected credit loss allowance for financial assets measured at amortised cost and FVOCI is an area that requires the use of complex models and significant assumptions about future economic conditions (e.g. future house price growth) and credit behaviour. Explanation of the inputs, assumptions and estimation techniques used in measuring ECL is further detailed on page 36, which also sets out key sensitivities of the ECL to changes in these elements on page 38.

A number of significant judgments are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk;
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing Groups of similar financial assets for the purposes of measuring ECL.

Detailed information about the judgments and estimates made by the Group in the above areas is set out in Note 1b.

1. Accounting policies and financial risk management

c) Critical accounting estimates and judgments in applying accounting policies (continued)

Credit risk exposure

Information regarding the Group's credit risk exposures at 31 December 2022 and 31 December 2021, including corresponding expected credit losses and coverage ratios, can be found in the tables below.

At 31 December 2022	Stage 1	Stage 2	Stage 3	Purchased credit-impaired	Total
Gross exposure (£000)					
Fully secured on residential property	59,752	10,311	18,712	10,807	99,582
Fully secured on land	-	5,906	5,241	-	11,147
Other loans	26	28	61	-	115
Total	**59,778**	**16,245**	**24,014**	**10,807**	**110,844**
Expected credit loss (£000)					
Fully secured on residential property	36	100	2,174	9,204	11,514
Fully secured on land	-	19	191	-	210
Other loans	-	-	-	-	-
Total	**36**	**119**	**2,365**	**9,204**	**11,724**
Coverage ratio (%)					
Fully secured on residential property	0.1%	1.0%	11.6%	85.2%	11.6%
Fully secured on land	-	0.3%	3.7%	-	1.9%
Other loans	-	-	-	-	-
Total	**0.1%**	**0.7%**	**9.8%**	**85.2%**	**10.6%**

At 31 December 2021	Stage 1	Stage 2	Stage 3	Purchased credit-impaired	Total
Gross exposure (£000)					
Fully secured on residential property	76,141	11,438	21,222	11,269	120,070
Fully secured on land	-	7,235	6,440	-	13,675
Other loans	102	-	98	-	200
Total	**76,243**	**18,673**	**27,760**	**11,269**	**133,945**
Expected credit loss (£000)					
Fully secured on residential property	70	54	1,782	9,298	11,204
Fully secured on land	-	46	1,738	-	1,784
Other loans	-	-	-	-	-
Total	**70**	**100**	**3,520**	**9,298**	**12,988**
Coverage ratio (%)					
Fully secured on residential property	0.1%	0.5%	8.4%	82.5%	9.3%
Fully secured on land	-	0.6%	27.0%	-	13.0%
Other loans	-	-	-	-	-
Total	**0.1%**	**0.5%**	**12.7%**	**82.5%**	**9.7%**

1. Accounting policies and financial risk management

c) Critical accounting estimates and judgments in applying accounting policies (continued)

Collateral and other credit enhancements

The Group's policies regarding collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

A portion of the Group's financial assets originated by the mortgage business has sufficiently low 'loan to value' (LTV) ratios, which results in no loss allowance being recognised in accordance with the Group's expected credit loss model. The carrying amount of such financial assets is £27.5m as at 31 December 2022 (2021: £33.7m).

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses.

Individually assessed financial assets that are credit-impaired (this excludes purchased-credit impaired assets) and related collateral held in order to mitigate potential losses are shown below:

	Gross Exposure	Impairment Allowance	Carrying amount	FV of collateral held *
	£000	£000	£000	£000
Fully secured on residential property	6,478	2,094	4,384	4,985
Fully secured on land	4,492	190	4,302	6,050
Other loans	25	-	25	-
Total	10,995	2,284	8,711	11,035

* Latest valuation of collateral used in impairment calculations

The following table shows the distribution of LTV ratios for the Group's credit-impaired individually assessed portfolio:

LTV distribution	Credit Impaired (gross carrying amount) £000
Lower than 50%	502
50 to 60%	165
60 to 70%	1,339
70 to 80%	997
80 to 90%	4,070
90 to 100%	-
Higher than 100%	3,922
Total	10,995

Loss Allowance

The loss allowance in the period is impacted by a variety of factors, as described below:

- Transfers between stages due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit impaired in the period, and the consequent "step up" (or "step down") between 12 month and Lifetime ECL
- Releases for instruments derecognised during the period
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models
- Impacts on the measurement of ECL due to changes made to models and assumptions
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis
- Financial assets derecognised during the period and write offs of allowances related to assets that were written off during the period.

The following tables explains the changes in the loss allowance during 2022 and 2021 due to these factors:

1. Accounting policies and financial risk management

c) Critical accounting estimates and judgments in applying accounting policies (continued)

	Stage 1	Stage 2	Stage 3		
	12-month ECL £000	Lifetime ECL £000	Lifetime ECL £000	Purchased credit-impaired £000	Total £000
Loss allowance as at 31 December 2021	**70**	**100**	**3,520**	**9,298**	**12,988**
Movements with P&L Impact					
Transfers (deterioration in credit):					
Transfers from Stage 1 to Stage 2	(3)	7	-	-	4
Transfers from Stage 1 to Stage 3	-	-	-	-	-
Transfers from Stage 2 to Stage 3	-	-	-	-	-
Transfers (cure):					
Transfers from Stage 2 to Stage 1	1	(2)	-	-	(1)
Transfers from Stage 3 to Stage 2	-	-	-	-	-
Transfers from Stage 3 to Stage 1	-	-	-	-	-
ECL release due to redemption	(17)	(2)	(190)	(23)	(232)
Other movements	(15)	16	675	(71)	605
Total net P&L release during the period	**(34)**	**19**	**485**	**(94)**	**376**
Movements with no P&L Impact					
Write-offs	-	-	(1,640)	-	(1,640)
Loss allowance as at 31 December 2022	**36**	**119**	**2,365**	**9,204**	**11,724**

	Stage 1	Stage 2	Stage 3		
	12-month ECL £000	Lifetime ECL £000	Lifetime ECL £000	Purchased credit-impaired £000	Total £000
Loss allowance as at 31 December 2020	**140**	**256**	**4,766**	**9,154**	**14,316**
Movements with P&L Impact					
Transfers (deterioration in credit):					
Transfers from Stage 1 to Stage 2	(9)	15	-	-	6
Transfers from Stage 1 to Stage 3	-	-	1	-	1
Transfers from Stage 2 to Stage 3	-	(3)	4	-	1
Transfers (cure):					
Transfers from Stage 2 to Stage 1	1	(3)	-	-	(2)
Transfers from Stage 3 to Stage 2	-	-	-	-	-
Transfers from Stage 3 to Stage 1	-	-	-	-	-
ECL release due to redemption	(25)	(1)	(15)	(23)	(64)
Other movements	(37)	(164)	(53)	167	(87)
Total net P&L charge during the period	**(70)**	**(156)**	**(63)**	**144**	**(145)**
Movements with no P&L Impact					
Write-offs	-	-	(1,183)	-	(1,183)
Loss allowance as at 31 December 2021	**70**	**100**	**3,520**	**9,298**	**12,988**

In the tables above, other movements are driven by changes to any of the modelling inputs other than stage, such as collateral revaluations, or different repayments to those forecast.

1. Accounting policies and financial risk management

c) Critical accounting estimates and judgments in applying accounting policies (continued)

(ii) Insurance risk

The Society's lifetime mortgages total £44.5m gross (2021: £42.6m gross). All loans are at rates of interest that are fixed for the duration of the mortgage; at inception LTVs were low and borrowers were above the age of 60. Borrowers do not make monthly repayments; instead under their contractual terms, interest is capitalised within the balance and becomes repayable on redemption of the loan.

The mortgage contracts contain a clause that behaves like an insurance policy, where in certain circumstances, if the redemption receipt from sale of property is less than the contractual sum due, the Society cannot pursue the borrower or the estate for the shortfall. This exposes the Society to the risk that the redemption balance may not be recovered fully. Impairment provisions are calculated using projection data regarding the expected remaining term of the loan and both historic and forecast Spanish HPI data. As forecast redemption dates can be 20+ years in the future, the impairment provision is most sensitive to the value of the property at redemption, where a small change in property value assumptions in the earlier years can have a notable impact on the estimated redemption receipt.

Projection data obtained from external UK sources indicates average long-term year-on-year Spanish HPI appreciation at 2.18% (2021: 2.34%) over a 25 year period. If this HPI were to decrease by 0.5% per annum, the insurance provision would increase from its current level of £11.5m to £12.3m; an increase in HPI of 0.5% per annum would see the provision reduce to £10.8m. Mortality rates are based on a third party actuarial assessment. The provision is not particularly sensitive to the date of redemption; in the event that borrowers were to live for 5 years longer than current predictions the insurance provision would decrease by £0.5m. Pre-payment rates refer to earlier than expected repayments and are estimated to be 5.5% (2021: 5.5%), based on experience to date. A 0.5% decrease in the pre-payment rate would see the insurance risk provision increase from £11.5m to £11.9m whilst a 0.5% increase in pre-payment would result in a reduction in the insurance risk provision from £11.5m to £11.2m.

65% of loan balances in the Spanish lifetime portfolio are believed to have an LTV in excess of 100%. The roll-up of interest on these loans results in an additional provision requirement absent of house price growth and redemptions. Based on current assumptions of a decline in house price growth in 2023, if there were no redemptions in 2023, the additional provision requirement on properties in negative equity would be c. £0.6m.

d) Segmental Analysis

The Group's results are predominately derived from the Society's principal activities. The Group's other income streams are not sufficiently material to require segmental reporting. The chief operating decision maker of the Group and the Society is deemed to be the Group's Board.

2. Interest receivable and other similar income

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Interest Receivable				
On loans fully secured on residential property	3,720	3,626	3,575	3,456
On other loans	590	523	590	523
On other liquid assets	572	41	572	41
	4,882	4,190	4,737	4,020
Other Similar Income				
On loans fully secured on residential property	3,034	3,354	3,034	3,354
	3,034	3,354	3,034	3,354

'Other similar income' reflects income generated from the Group's portfolio of Spanish lifetime mortgage loans, which are categorised as insurance contracts. Under IFRS 4 the Group has continued to account for these mortgage contracts using its existing accounting policies and, following the implementation of IFRS 9 in 2018, this income has been recorded as 'other similar income'.

Other than £3.0m (2021: £3.4m) generated on loans originating in Spain and Portugal, all interest receivable and other similar income has been generated within the United Kingdom.

3. Interest payable and similar charges

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
On amounts due to members	1,010	558	1,010	558
On deposits and other borrowings				
Subordinated liabilities	683	525	683	525
Subscribed Capital (Note 24)	400	263	400	263
Lease liabilities (Note 27)	13	18	13	18
Other	25	7	25	7
	2,131	1,371	2,131	1,371

4. Legal damages and interest

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Legal damages and related interest received	-	14,272	-	14,272
Legal costs recovered	2,400	7,540	2,400	7,540

The Society pursued legal proceedings against its former auditors, Grant Thornton (UK) LLP, following the write down booked in 2012. In June 2021, the Society's appeal against the decisions of the High Court and Court of Appeal was upheld by the Supreme Court. As a result of this judgment the Society was awarded damages of £13.4m. In addition, the Society received £0.9m of interest on damages and £7.5m of costs and interest on those costs in 2021. During 2022, a further £2.4m was recovered by the Society as full and final settlement.

5. Other operating income and other operating charges

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Income				
Interest from subsidiaries	-	-	-	3
Other income from subsidiaries	-	-	120	120
Dividend income from subsidiaries	-	-	-	400
Exchange gains and losses	2,553	-	2,473	-
Fair value gains and losses on derivatives	(1,646)	-	(1,646)	-
	907	-	947	523
Charges				
Exchange gains and losses	-	(1,396)	-	(1,281)
Fair value gains and losses on derivatives	-	635	-	635
Rents payable	(2)	(17)	(2)	(17)
Other	-	(31)	-	(31)
	(2)	(809)	(2)	(694)

Exchange gains and losses arise principally in respect of the Spanish lifetime mortgage book and are partially offset by the fair value gains and losses from the economic hedging activity with foreign exchange derivatives as explained on page 6.

All rents payable by the Society and Group under operating leases is payable to third parties.

6. Administrative expenses

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Employee costs (including Executive Directors)				
Wages & salaries	1,970	1,779	1,970	1,779
Social security costs	215	181	215	181
Pension costs	188	175	188	175
	2,373	2,135	2,373	2,135
Other administrative expenses	2,914	2,598	2,880	2,572
	5,287	4,733	5,253	4,707

Other administrative expenses include:

Remuneration of the auditors (Inclusive of Value Added Tax)

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Fees payable to the auditors for audit of the annual accounts				
Current year	351	341	351	341
Adjustment to fees in relation to the audit of the prior year	-	-	-	-
Fees payable to the auditors for other services				
Audit of the accounts of subsidiary	5	5	-	-
Other assurance services	-	24	-	24
	356	370	351	365

Other assurance services were performed to provide a profit verification on the interim financial results at 30 June 2021. This verification was required to allow the Group to recognise the profits for the year to date within regulatory capital to facilitate the payment of the October 2021 PIBS coupons.

7. Employees

The average number of persons employed during the year was:

	Group 2022 Number	Group 2021 Number	Society 2022 Number	Society 2021 Number
Full-time	33	32	33	32
Part-time	11	11	11	11
	44	43	44	43

8. Directors' emoluments

Executive directors

	Salary £000	Pension Contributions £000	Bonus £000	Benefits £000	Total £000
2022					
P.A. Lynch	175	21	10	1	207
M.A. Winterbottom	123	15	10	1	149
	298	36	20	2	356
2021					
P.A. Lynch	170	21	10	1	202
M.A. Winterbottom	120	14	10	1	145
	290	35	20	2	347

Non-executive directors

	Fees 2022 £000	Fees 2021 £000
H.F. Baines	43	40
I.A. Dewar	38	35
D.A. Harding	85	80
J. Lincoln	38	35
F.B. Smith	38	35
	242	225

Total directors' emoluments

	2022 £000	2021 £000
Executive directors	356	347
Non-executive directors	242	225
Total directors' emoluments	598	572

Further details regarding Key Management Personnel may be found in Note 28.

9. Tax expense

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Profit/ (loss) for the year before tax	1,058	20,837	971	21,458
Tax rate	19.00%	19.00%	19.00%	19.00%
Expected tax expense / (credit)	201	3,959	184	4,077
Adjustment for non-deductible items	84	-	84	-
Income not taxable	-	-	-	(76)
Fair value movement on assets held for sale	29	37	29	37
Group relief surrendered free of charge	-	-	-	(42)
Current year losses for which no deferred tax asset recognised	-	-	-	-
Profits of year covered by brought forward losses in respect of which no deferred tax asset recognised	(19)	(2,352)	(2)	(2,352)
Current period Statement of Changes in Equity expense without offsetting entries in Statement of Comprehensive Income or Statement of Changes in Equity	(128)	-	(128)	-
Decrease in deferred tax asset recognised	(167)	(177)	(167)	(177)
Actual tax expense	-	1,467	-	1,467
Comprising				
Deferred tax origination and reversal of timing difference	-	1,467	-	1,467
	-	1,467	-	1,467

10. Loans and advances to credit institutions

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Accrued interest	23	-	23	-
Repayable on demand	4,993	10,589	4,992	10,588
	5,016	10,589	5,015	10,588

11. Derivative financial instruments – Group and Society

Exchange rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currency rates (for example, Sterling for Euros). No exchange of principal takes place. The Group's credit risk represents the potential cost to replace the swap contracts if counterparties fail to perform their obligations. This risk is monitored by reference to the fair value of the notional amount of the contracts and the liquidity of the market. To control the level of credit risk taken, the Group assesses counterparties using techniques including credit ratings. The fair value is based on the current discounted cash flows of the swaps when compared with the current exchange rate yields.

The Group uses foreign exchange forward contracts and swaps for hedging purposes. All derivative financial instruments are held for economic purposes.

The following table describes the significant activities undertaken by the Group, the risks associated with such activities and the types of derivatives which are typically used in managing such risks.

Activity	Risk	Type of derivative instruments used
Mortgage lending in Euros	Sensitivity to changes in exchange rates	Exchange rate swaps-

	Notional amount £000	Fair value Assets £000	Fair value Liabilities £000
Derivatives held at 31 December 2022			
Exchange rate swaps	35,457	12	956
	35,457	12	956
Derivatives have remaining maturities as follows:			
Up to three months	12,732	10	426
Three to six months	12,957	2	384
Six to twelve months	9,768	-	146
	35,457	12	956
Derivatives held at 31 December 2021			
Exchange rate swaps	34,591	712	9
	34,591	712	9

12. Loans and advances to customers

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Loans fully secured on residential property	120,991	141,209	118,252	138,143
Loans fully secured on land	10,937	11,891	10,937	11,891
Other loans	115	200	115	200
	132,043	153,300	129,304	150,234

At 31 December 2022 the Group had €51.8m (2021: €52.6m) of loans denominated in Euros. These were converted into Sterling at a rate of €1.1287 to the pound (2021: €1.1951). Spanish lifetime mortgages represent £32.9m of the loans fully secured on residential property as at 31 December 2022 (2021: £32.3m).

Maturity analysis

The remaining maturity of loans and advances to customers from the date of the financial position is as follows:

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Repayable on demand	7,143	10,348	7,129	10,327
Other loans and advances secured by residual maturity repayable:				
In not more than three months	3,744	1,006	3,666	891
In more than three months but not more than one year	9,965	7,790	9,523	7,293
In more than one year but not more than five years	38,870	39,554	38,187	38,344
In more than five years	95,593	117,857	85,494	108,042
	155,315	176,555	143,999	164,897
Less: impairment provisions	(23,272)	(23,255)	(14,695)	(14,663)
	132,043	153,300	129,304	150,234

The Group's experience is that, in many cases, mortgages are redeemed before their natural or contractual redemption dates. As a consequence the maturity analysis above may not reflect actual experience.

GROUP		Balance at 31 December 2021 £000	(Credit)/ charge for the year £000	Utilised during the year £000	Balance at 31 December 2022 £000
Loans fully secured on residential property	Expected Credit Loss Risk	11,204	526	(216)	11,514
	Collective Insurance Risk	10,267	2,119	(838)	11,548
Loans fully secured on land	Expected Credit Loss Risk	1,784	(151)	(1,423)	210
Other Loans	Expected Credit Loss Risk	-	-	-	-
Total		**23,255**	**2,494**	**(2,477)**	**23,272**

SOCIETY		Balance at 31 December 2021 £000	(Credit)/ charge for the year £000	Utilised during the year £000	Balance at 31 December 2022 £000
Loans fully secured on residential property	Expected Credit Loss Risk	2,613	542	(217)	2,938
	Collective Insurance Risk	10,267	2,119	(838)	11,548
Loans fully secured on land	Expected Credit Loss Risk	1,783	(151)	(1,423)	209
Other Loans	Expected Credit Loss Risk	-	-	-	-
Total		**14,663**	**2,510**	**(2,478)**	**14,695**

Total impairment losses in the Statement of Comprehensive Income of the Group and Society are disclosed in Note 13.

13. Impairment losses/ (gains)

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Expected credit losses / (gains)				
Impairment losses / (gains) on loans and advances to customers on residential property and land	375	(146)	391	(273)
Amounts recovered on loans and advances to customers on residential property and land, written off in prior periods	(1)	(5)	(1)	(5)
Total expected credit losses / (gains)	374	(151)	390	(278)
Other impairment losses				
Impairment losses on loans and advances to customers on lifetime mortgages	2,119	1,440	2,119	1,440
Total other impairment losses	2,119	1,440	2,119	1,440
Total impairment losses	2,493	1,289	2,509	1,162

Impairment losses on loans and advances to customers on Spanish lifetime mortgages includes £623k of losses on foreign exchange (2021: £762k gains). These are offset by the £907k of exchange gains included within other operating income and charges as disclosed in Note 5. The use of foreign exchange derivatives as an economic hedge for the Spanish lifetime mortgage book is explained on page 6.

14. Investments

Subsidiary undertakings	Shares £000	Loans £000	Total £000
At 1 January 2022	1	291	292
Net payments	-	(411)	(411)
At 31 December 2022	1	(120)	(119)

No impairment was made to the Society's investment in MBS (Mortgages) Limited in the year (2021: nil) due to the continued improved repayment performance of the underlying NMB MAC loan book. The repayments received during 2022 have resulted in the Society owing funds to MBS (Mortgages) as at 31 December 2022. The directors consider that the carrying value of the intragroup balance is supported by the Society's net assets.

MBS (Mortgages) Limited holds a portfolio of mortgage assets, some of which are regulated by the MCOB. Remediation of a number of these accounts following periods of non-compliance is detailed in Note 30.

Subsidiary	**Nature of Business**	**Country of Incorporation and place of business**	**Proportion of Ordinary shares held**
MBS (Mortgages) Limited	Mortgage lending	England	100%

MBS (Mortgages) Limited is wholly owned and wholly funded by the Society, the registered addresses are the same as that for the Society. The Society's ability to recover its investment in this subsidiary is based upon the cash flows that this subsidiary can generate.

15. Intangible assets – Group and Society

	Computer Software £000	Total £000
Cost		
At 1 January 2022	57	57
Additions	-	-
At 31 December 2022	57	57
Accumulated amortisation		
At 1 January 2022	13	13
Charge for the year	11	11
At 31 December 2022	24	24
Carrying amount		
At 31 December 2022	33	33
At 31 December 2021	44	44

Computer software relates to the Group's investment in an upgraded nominal ledger and purchase ledger. All computer software capitalised has an estimated useful life of 5 years.

16. Property, plant and equipment

Group and Society	Right-of-use assets £000	Fixtures and equipment £000	Total £000
Cost			
At 1 January 2022	397	718	1,115
Additions	-	5	5
Disposals	-	(412)	(412)
At 31 December 2022	397	311	708
Accumulated depreciation			
At 1 January 2022	189	697	886
Charge for the year	80	11	91
Eliminated on disposal	-	(412)	(412)
At 31 December 2022	269	296	565
Carrying amount			
At 31 December 2022	128	15	143
At 31 December 2021	208	21	229

17. Non-current assets classified as held for sale

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Non-current assets classified as held for sale				
Properties under Society control, previously used as collateral for loans fully secured on residential property	291	491	291	491
	291	491	291	491
Net loss on non-current assets classified as held for sale				
Net loss from fair value movements on properties under Society control, previously used as collateral for loans fully secured on residential property	155	194	155	194
	155	194	155	194

At 31 December 2021 the Society held two properties that had previously acted as collateral for two Spanish lifetime mortgage contracts. One of the properties was sold during 2022, for no loss. The other property remains in the possession of the Society, with a £155k fair value loss recorded in 2022.

This asset is available for immediate sale and management assessed a sale within 12 months as highly probable, with the assets being actively marketed for sale at sales prices judged to be reasonable in relation to their fair values. The asset is held at the lower of its carrying amount and fair value less costs to sell.

18. Deferred tax assets

Deferred taxes are calculated on all temporary differences under the liability method using an effective tax rate of 25.00% (2021: 19.00%). There were no movements on the deferred tax account in the year.

Deferred tax assets are recognised for tax loss carry-forwards to the extent that the realisation of the related tax benefits through future taxable profits is probable.

The main rate of corporation tax in the UK 19% and will increase to 25% on 1 April 2023.

The carrying value of the deferred tax asset (DTA) is £nil as no further assets have been recognised.

The Group's long-term financial projections, based on a managed run-off of the balance sheet without a return to lending, indicate that the underlying operations of the Group will remain profitable in the short to medium-term. In the medium to long-term it is likely that the net interest margin will be insufficient to cover operating costs and loan impairment charges, resulting in operating losses.

It should be noted that the DTA de-recognised in prior years is still available for tax relief purposes, as tax losses can be carried forward indefinitely under UK tax rules and can be used subject to the availability of future taxable profits.

In addition to the recognised deferred taxation assets and liabilities, certain deferred tax assets have not been recognised.

At 31 December 2022 for the Group, these were:

- £1,484k arising from timing differences on derivative contracts (2021: £1,691k) and
- £4,821k arising from losses (2021: £4,844k)
- £67k arising from accelerated tax depreciation and short-term temporarily deferred (2021: £81k)

At 31 December 2022 for the Society, these were:

- £1,484k arising from timing differences on derivative contracts (2021: £1,691k) and
- £2,806k arising from losses (2021: £2,808k)
- £67k arising from accelerated tax depreciation and short-term temporarily deferred (2021: £81k)

19. Other assets

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Amounts due within one year				
Credit support annex	2,155	1,110	2,155	1,110
Prepayments	268	363	268	363
Other assets	85	64	85	64
	2,508	1,537	2,508	1,537

The credit support annex balances represent the sums deposited by the Society with its derivative counterparties to collateralise the derivatives issued. The balances, whilst in cash form, are not included within Liquid Assets.

20. Due to members

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Held by individuals	129,389	150,254	129,389	150,254
Shares are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	240	37	240	37
Repayable on demand	41,785	46,361	41,785	46,361
Other shares by residual maturity repayable:				
In not more than three months	62,898	71,501	62,898	71,501
In more than three months but not more than one year	24,466	32,355	24,466	32,355
In more than one year but not more than five years	-	-	-	-
	129,389	150,254	129,389	150,254

21. Other deposits

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Amounts owed to other deposit customers are repayable from the financial position date in the ordinary course of business as follows:				
Accrued interest	22	4	22	4
Repayable on demand	3,878	4,421	3,878	4,421
Other amounts owed to other deposit customers by residual maturity repayable:				
In not more than three months	2,295	2,611	2,295	2,611
	6,195	7,036	6,195	7,036

22. Subordinated liabilities

	Group and Society 2022 £000	Group and Society 2021 £000
Subordinated loans		
Loan repayable 2032 (fixed rate of interest of 6.70%)	-	5,000
	-	5,000

The subordinated loan was taken to assist the financing of future development. The loans existed for a fixed period and the Society had the option to prepay the loan at par 5 years prior to the final repayment dates.

The loan was redeemed in March 2022 via a negotiated settlement.

23. Other liabilities

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Amounts falling due within one year:				
Taxation and social security	95	91	95	91
Creditors	142	188	144	187
Credit support annex	-	220	-	220
Lease liabilities (Note 27)	124	204	124	204
Interest accrued on subordinated liabilities	-	84	-	84
Accruals	651	500	644	493
	1,012	1,287	1,007	1,279

The credit support annex balances represent the sums deposited with the Society by its derivative counterparties to collateralise the derivatives issued. The deposits received by the Society are included within Liquid Assets.

24. Subscribed capital

The Society has two tranches of PIBS in issue. The first tranche was issued in 1999 and is remunerated at 8.00% and the other was issued in 2005 and is remunerated at 6.75%.

The two tranches are accounted for differently as they are subject to differing legal arrangements. Both tranches of PIBS are unsecured and rank pari passu with each other. In priority terms, the PIBS holders rank behind the Society's depositing members, its wholesale counterparties and the subordinated notes holder.

Classified as a liability:	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
8.00% Permanent Interest Bearing Shares	5,000	5,000	5,000	5,000
	5,000	5,000	5,000	5,000

Under the terms of offer, the Board may, subject to a resolution, cancel in whole or in part any scheduled interest payment due to holders of the 8.00% PIBS in restricted circumstances, when the Society were to have in issue other shares or deposits (save for deferred shares) on which the Board could cancel interest at its discretion. As no such class of share or deposit was in issue at either of the financial statement dates, it has been assessed that the terms of the PIBS confer a contractual obligation on the Society to deliver cash in the form of interest payments and as such, the 8.00% PIBS are treated as a liability on the part of the Society and any interest is booked to the Statement of Comprehensive Income (Note 3).

Classified as equity:	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
6.75% Permanent Interest Bearing Shares	9,788	9,788	9,788	9,788
	9,788	9,788	9,788	9,788

Under the terms of offer, the Board may at its sole discretion, subject to a resolution, cancel in whole or in part any scheduled interest payment due to holders of the 6.75% PIBS. Whilst the Board does not intend to avail itself of this discretion, the facility to do so results in the assertion that the PIBS should be considered not to confer a contractual obligation on the Society to deliver cash in the form of interest payments. As such, the 6.75% PIBS are treated as forming a part of the Society's equity and interest is booked to Statement of Changes in Equity.

The Group met all of the quantitative and qualitative requirements regarding the level of regulatory capital it must hold throughout the year and made the coupon payments on both its issuances of PIBS. Whilst the Society continues to manage down the size of the balance sheet, there remains some uncertainty over the Society's ability to make PIBS coupon payments in the medium to long-term.

The Group continues to follow a medium to long-term strategic plan, against which it is monitored by the PRA. The plan shows that the Society remains viable in the medium-term. It is recognised, however, that there are a number of long-term risks to this plan, particularly following a stress event in the economy or financial markets.

25. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprises the following balances with less than three months maturity from the date of acquisition:

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Cash and balances with central banks	38,223	37,704	38,223	37,704
Loans and advances to credit institutions	4,993	10,589	4,992	10,588
	43,216	48,293	43,215	48,292

The above balances exclude accrued interest. £23k of interest was accrued at 31 December 2022 (2021: £nil).

26. Profit Participating Deferred Shares

	Group 2022 £000	Group 2021 £000	Society 2022 £000	Society 2021 £000
Nominal value - proceeds received	18,000	18,000	18,000	18,000
Less: issue costs	(539)	(539)	(539)	(539)
Book value	17,461	17,461	17,461	17,461
PPDS Reserve Account at 1 January (memo)	2,053	(3,676)		
Share of profit for the year	115	5,729		
PPDS Reserve Account at 31 December (memo)	2,168	2,053		

The Society issued £18m of PPDS in April 2013. The PPDS are deferred shares for the purposes of Section 119 of the Building Societies Act 1986 (as amended). They are perpetual instruments with no maturity date or right to repayment other than on a winding-up; in the event of a winding-up, the PPDS would rank below claims in respect of the Society's PIBS. The PPDS are not protected deposits for the purposes of the Financial Services Compensation Scheme. They are eligible as Common Equity Tier 1 Capital for regulatory purposes. Save as described below, the holders of the PPDS are eligible to receive a dividend, at the discretion of the Board of the Society, of up to 30% (the "Participation Percentage") of the annual consolidated post-tax profits of the Society and its subsidiary (calculated prior to payment of the PPDS dividend and subject to certain other adjustments).

The PPDS will also absorb the Participation Percentage of any consolidated post-tax losses recorded by the Society and its subsidiary, any such amount being debited to a reserve account maintained by the Society for the purpose of the PPDS (the "PPDS Reserve Account"). Any net profits which are eligible to be paid to holders of PPDS as dividends but which are not so paid will be credited to the PPDS Reserve Account.

No dividend has been declared in the year.

27. Leases

The Society leases the office space on the fifth floor of 125 Portland Street, Manchester, which is used as the Group's head office.

In 2019, the Society entered into a formal lease agreement as tenant for the fifth floor of 125 Portland Street, covering a five year period with an option to break the lease after three years. As the lease term exceeds 12 months, the Society and Group are required to account for the lease under IFRS 16 - *Lease Accounting*. The contractual five year lease term is used as the basis of the initial accounting for the lease under IFRS 16.

The Society has recognised a lease liability for the fifth floor lease arrangement, which was initially measured as the present value of the total lease payments due over the lease term, discounted using the rate implicit in the lease. This liability is included on the Statement of Financial Position within other liabilities (Note 23). This liability incurs interest expenditure at the rate implicit in the lease, which is recognised in the Statement of Comprehensive Income as part of interest payable and similar charges (Note 3). Lease payments by the Society reduce the amount of this liability.

Lease Liability Maturity Analysis	**Group 2022 £000**	**Group 2021 £000**	**Society 2022 £000**	**Society 2021 £000**
Not later than 1 year	86	80	86	80
Later than 1 year and not later than 5 years	38	124	38	124
Total lease liability (Note 23)	124	204	124	204

The Society has recognised a right-of-use asset for the lease, which is included on the Statement of Financial Position within property, plant and equipment (Note 16), with depreciation charged through the Statement of Comprehensive Income (Note 16). This asset was initially measured as the present value of future lease payments due over the lease term plus initial direct costs incurred by the Society in relation to the lease set up. The rate implicit in the lease has been used to derive the initial present value of the right-of-use asset. Depreciation is charged on a straight-line basis over the five year period covered by the lease agreement.

The following amounts have been recognised within the Statements of Comprehensive Income in relation to leases:

	Group 2022 £000	**Group 2021 £000**	**Society 2022 £000**	**Society 2021 £000**
Depreciation expense on right-of-use assets (Note 16)	80	79	80	79
Interest expense on lease liabilities (Note 3)	13	18	13	18
Expense relating to short-term leases	2	17	2	17
	95	114	95	114

28. Related party transactions

Key Management Personnel. The directors, the Operational Risk & Compliance Manager, and the HR & Central Administration manager are considered to be the Key Management Personnel as defined by *IAS 24 – Related Party Disclosures*. In line with the Board's continuing policy, there were no loans provided to any of these individuals or their close family members (2021: nil). None of the directors, or their close family members held any of the Society's PIBS (2021: nil).

The total remuneration of Key Management Personnel was as follows:

	Group 2022 £000	**Group 2021 £000**
Executive directors (Note 8)	356	347
Non-executive directors (Note 8)	242	225
Key Management Personnel	110	96
	708	668

28. Related Party Transactions (continued)

Transactions with other related parties: The Society had no transactions with other related parties during the year and no balances are outstanding at 31 December in relation to transactions with other related parties.

Register: In accordance with sections 68 and 69 of the Building Societies Act 1986 a register of transactions is maintained at the Society's head office which shows details of all transactions and arrangements with directors and connected persons.

Subsidiary: The Group is controlled by Manchester Building Society; details of the subsidiary undertaking may be found in Note 14.

The Society had the following transactions with its subsidiary undertaking during the year:

(i) Current loan accounts - unsecured	Society 2022 £000	Society 2021 £000
As at 1 January	291	332
Loans issued during the year	272	664
Loan repayments during the year	(682)	(705)
At 31 December	(119)	291
(ii) Interest income charged to subsidiaries	-	4

No dividend (2021: £400k) was proposed and paid in full to the Society by MBS (Mortgages) Limited in the year.

29. Financial commitments

(i) Capital commitments:

The Group has no capital commitments as at 31 December 2022 (2021: nil).

The Society leases its head office from a third party. The current lease runs until August 2024. (Note 27).

Contingent liabilities are considered in Note 31.

30. Provisions for liabilities and charges

No provisions for liabilities and charges were held at either 31 December 2022 or 31 December 2021.

31. Contingent liabilities and assets

(i) Contingent liabilities:

Given the high level of scrutiny regarding financial institutions' treatment of customers and business conduct from regulatory bodies and other sources there is a risk that certain aspects of the Group's current or historic business, including, amongst other things, MCOB regulated loans, may be determined by the FCA and other regulatory bodies or the courts as, in their opinion, not being conducted in accordance with applicable laws or regulations, or fair and reasonable treatment.

In recent years the Group has undertaken a redress and remediation programme in relation to the NMB MAC and CLC portfolios. These have now been completed and all known issues have been remediated. There remains a risk that other aspects of the Group's business might be considered as not having been conducted in accordance with all relevant regulation, or the fair and reasonable treatment of customers. It is also not possible to rule out the possibility of other instances of non-compliance with regulations which have not been identified. No provisions against these risks are included in these financial statements.

(ii) Contingent assets:

The group has no contingent assets.

ANNUAL BUSINESS STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2022

1. Statutory limits

	2022	Statutory
	%	% limit
Lending limit	8.9	25.0
Funding limit	4.6	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986, as amended by the Building Societies Act 1997.

The Lending limit measures the proportion of business assets not in the form of loans fully secured on residential property and is calculated as (X - Y) ÷ X where:

X = business assets, being the total assets of the Group plus provisions for bad and doubtful debts less liquid assets, tangible fixed assets and intangible assets as shown in the Group financial statements.

Y = the principal of, and interest accrued on, loans owed to the Group which are fully secured on residential property and mortgage loss provisions.

The Funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals and is calculated as (X - Y) ÷ X where:

X = shares and borrowings, being the aggregate of:

(i) the principal value of, and interest accrued on, shares in the Society;
(ii) the principal value of, and interest accrued on, sums deposited with the Society or any subsidiary undertaking of the Society;
(iii) the principal value of, and interest accrued under, bills of exchange, instruments or agreements creating or acknowledging indebtedness and accepted, made, issued or entered into by the Society or any such undertaking less any amounts qualifying as own funds.

Y = the principal value of, and interest accrued on, shares in the Society held by individuals otherwise than as bare trustees (or, in Scotland, simple trustees) for bodies corporate or for persons who include bodies corporate.

The statutory limits are laid down under the Building Societies Act 1986 as amended by the Building Societies Act 1997 and ensure that the principal purpose of a Building Society is that of making loans which are secured on residential property and are funded substantially by its members.

Other ratios

As a percentage of shares and borrowings:

	2022	2021
	%	%
Gross capital	30.0	28.8
Free capital	29.9	28.6
Liquid assets	31.9	30.7
Leverage ratio	12.4	11.8

As a percentage of mean total assets:

Profit after taxation	0.49	9.09
Group management expenses (including legal costs recovered)	1.56	(1.26)
Group management expenses (excluding legal costs recovered)	2.82	2.28
Society management expenses (including legal costs recovered)	1.57	(1.29)
Society management expenses (excluding legal costs recovered)	2.84	2.30

The above percentages have been prepared from the Group financial statements and in particular:

'Shares and borrowings' represent the total of amounts due to customers, amounts owed to banks, amounts owed to other depositors and debt securities in issue in the Group statement of financial position.

'Gross capital' represents the aggregate of reserves, other borrowed funds, profit participating deferred shares and subscribed capital as shown in the Group statement of financial position.

'Free capital' represents the aggregate of gross capital and collective loss provisions for bad and doubtful debts less property, plant and equipment in the Group statement of financial position.

'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year for the Group/Society.

'Liquid assets' represent the total of cash and balances with central banks, loans and advances to banks and debt trading securities in the Group statement of financial position.

'Leverage ratio' is the ratio of Tier 1 capital divided by total exposure, which includes the sum of on balance sheet exposures, derivative exposures and off balance sheet items.

'Management expenses' represent the aggregate of administrative expenses and depreciation taken from the Group/Society Statements of Comprehensive Income.

ANNUAL BUSINESS STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2022

2. Information relating to the directors and officers as at 31 December 2022

Name	Date of birth	Date of appointment	Occupation	Other directorships
Directors				
H.F. Baines	12.3.1957	Aug 2013	Consultant	Halifax Pension Nominees Limited Harry Baines Consulting Limited HBOS Final Salary Trust Limited Lloyds Banking Group Pension Trustees Limited Lloyds Bank Pension Trust (No. 1) Limited Lloyds Bank Pension Trust (no. 2) Limited Lloyds Bank S.F. Nominees Limited Cadent Pension Trustees Cadent Gas Pension Property Company 1 Limited Cadent Gas Pension Property Company 2 Limited
I.A. Dewar	14.9.1957	Aug 2013	Chartered Accountant	Arbuthnot Banking Group Plc
D.A. Harding	29.7.1947	Apr 2013	Retired Company Director	
J. Lincoln	8.2.1957	Jul 2018	Retired Finance Director	Penrith Building Society
P.A. Lynch	31.8.1969	Apr 2002	Building Society Executive	MBS (Mortgages) Limited
F.B. Smith	3.1.1959	Jan 2014	Retired General Counsel	The Glenkens & District Trust (Trustee)
M.A. Winterbottom	19.9.1978	Jul 2018	Finance Director	MBS (Mortgages) Limited
Officers				
C. Blore			Financial Planning and Analysis Manager	
D. Callaghan			Treasurer and Financial Controller	
J.C. Johnson			Operational Risk and Compliance Manager	
R. Mervill			Customer Care Manager	
J. Platt			Finance Department Manager	
A.C. Pradena			Savings Customer Services Manager	
D. Spencer			Lending Manager	
M. Tang			IT and Operations Manager	
G.C. Worthington			HR and Central Administration Manager	

Executive Directors	Date of birth	Position	Date of signing service contract
P.A. Lynch	31.8.1969	Chief Executive	3.4.2002
M.A. Winterbottom	19.9.1978	Finance Director	5.9.2018

The executive directors each have an employment contract which is terminable by the Society by giving 12 months' notice. Each executive director is required to give 6 months' notice to the Society to terminate his or her contract.

ANNUAL BUSINESS STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2022

Information relating to the directors and officers as at 31 December 2022 (continued)

Non-Executive Directors

Non-executive directors are not appointed under service contracts. Their appointment is terminable by 1 month's notice on either side. In the event of the Society merging with another Society whilst D.A. Harding is the Chairman of the Board, he is entitled to 6 months' fees under his letter of appointment.

It is indicated to each non-executive director that they would not be expected to serve more than nine years on the board, although for the avoidance of doubt this is not a contractual commitment to the directors. Accordingly, by reference to a full nine-year term, the unexpired part of each non-executive director's term at 31 December 2022 would be:

H.F. Baines	Expired
I.A. Dewar	Expired
D.A. Harding	Expired
J. Lincoln	4 years and 6 months
F.B. Smith	1 month

Three of the non-executive directors completed their nine-year terms during 2022. Given the strategic decisions that the Society will need to make in the coming year, the existing directors have been asked to remain in position beyond the nine-year term. D.A. Harding and F.B. Smith will retire and being eligible, will offer themselves for re-election at the Society's 2023 Annual General Meeting.

Any documents may be served on the above named directors at the following address: Addleshaw Goddard, Milton Gate, 60 Chiswell Street, London EC1Y 4AG.

COUNTRY BY COUNTRY REPORTING

FOR THE YEAR ENDED 31 DECEMBER 2022

Capital Requirements (Country-by-Country) Reporting

The reporting obligations set out in Article 89 of the European Union's Capital Requirements Directive IV (CRD IV) have been implemented in the UK by the Capital Requirements (Country-by Country) Reporting Regulations.

Manchester Building Society is owned by its members. The means by which its value is preserved is by providing products that meet the financial needs of both existing and potential members.

The principal objectives of the Group remain the provision of competitive facilities for personal savings and for mortgage finance primarily to support owner occupation of residential property.

The Manchester Building Society Group is made up of:

Entity	Nature of Activity	Location
Manchester Building Society	Provision of mortgage and savings products	United Kingdom
and its wholly owned subsidiary:		
MBS (Mortgages) Limited	Mortgage lending	United Kingdom

All of the activities of the Society and its subsidiary are conducted in the United Kingdom and therefore 100% of the total operating income, profit before tax and the employee numbers disclosed below are related to the United Kingdom.

Basis of preparation – country-by-country reporting

Note 1 to the 2022 Annual Report and Accounts details the basis of preparation relating to going concern and accounting policies.

For the year ended 31 December 2022:

Group turnover (total operating income) was £6.5m (2021: £19.4m), the profit before tax was £1.1m (2021: £20.8m). Total operating income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable) together with other operating income and charges. In the year operating income included nil (2021: £14.3m) in relation to legal damages and interest awarded to the Group.

The average number of Group full time employees was 33 (2021: 32).

The Group and the Society paid £nil corporation tax for the year (2021: £1.5m).

No public subsidies were received by the Group and the Society in the year.

In 2022 the Society generated interest receivable and similar income of £3.0m (2021: £3.4m) in respect of Euro-denominated loans and advances made on properties in Spain, however, all activities of the Society were conducted in the United Kingdom.

Independent auditors' report to the directors of Manchester Building Society

Opinion

In our opinion, Manchester Building Society's Group and Society country-by-country information for the year ended 31 December 2022 has been properly prepared, in all material respects, in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

We have audited the country-by-country information for the year ended 31 December 2022 in the Country-by-Country Reporting.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)"), including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the country-by-country information section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group and Society in accordance with the ethical requirements that are relevant to our audit of the country-by-country information in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Emphasis of Matter - Basis of preparation

In forming our opinion on the country-by-country information, which is not modified, we draw attention to the basis of preparation note of the country-by-country information which describes the basis of preparation. The country-by-country information is prepared for the directors for the purpose of complying with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013. The country-by-country information has therefore been prepared in accordance with a special purpose framework and, as a result, the country-by-country information may not be suitable for another purpose.

Material uncertainty relating to going concern

In forming our opinion on the country-by-country information, which is not modified, we have considered the adequacy of the disclosure made in the basis of preparation note to the country-by-country information concerning the Group's and Society's ability to continue as a going concern which references Note 1 to the 2022 Annual Report and Accounts. Therein, the directors have set out the risks and uncertainties for the business given the proposed merger with Newcastle Building Society. If the merger is successful, the Society may cease to exist within the next twelve months.

These conditions, along with the other matters explained in Note 1 to the annual accounts, indicate the existence of a material uncertainty which may cast significant doubt about the Group's and Society's ability to continue as a going concern, The country-by-country information does not include the adjustments that would result if the Group and Society were unable to continue as a going concern.

In auditing the country-by-country information, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the country-by-country information is appropriate.

Our evaluation of the directors' assessment of the Group's and the Society's ability to continue to adopt the going concern basis of accounting included:

- Discussions held with the PRA to understand their approach to supervision of the Group and Society and review of other regulatory correspondence;
- Evaluating the Group and Society's performance against the PRA requirements set out in their medium to long-term strategic plan including; the current and forecast financial performance, regulatory metrics, and stressed scenarios against the plan; and
- Testing the disclosures regarding the risks and uncertainties facing the Group and Society made in Note 1 of the annual accounts based on our understanding of the business and discussions with management on the future strategic plan for the Group and Society.

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

Responsibilities for the country-by-country information and the audit

Responsibilities of the directors for the country-by-country information

The directors are responsible for the preparation of the country-by-country information in accordance with the requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013 as explained in the basis of preparation in note and accounting policies note to the country-by-country information, and for determining that the basis of preparation and accounting policies are acceptable in the circumstances. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of country-by-country information that is free from material misstatement, whether due to fraud or error.

In preparing the country-by-country information, the directors are responsible for assessing the Group and Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group and Society or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the country-by-country information

It is our responsibility to report on whether the country-by-country information has been properly prepared in accordance with the relevant requirements of the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

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

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the Group and Society and its industry, we identified that the principal risks of non-compliance with laws and regulations related to UK regulations, and we considered the extent to which non-compliance might have a material effect on the country-by-country information. We also considered those laws and regulations that have a direct impact on the country-by-country information such as applicable tax legislation and the Capital Requirements (Country-by-Country Reporting) Regulations 2013. We evaluated management's incentives and opportunities for fraudulent manipulation of the country-by-country information (including the risk of override of controls), and determined that the principal risks were related to the posting of inappropriate journal entries to increase income or reduce expenditure, including management bias in accounting estimates. There may be a greater risk of management bias to improve the capital position of the Society or ensure a favourable outcome on the proposed merger. Audit procedures performed included:

- Discussions with management and those charged with governance in relation to known or suspected instances of non-compliance with laws and regulation and fraud;
- Review of internal audit reports in so far as they related to the financial statements;
- Review of correspondence with and reports to the regulators;
- Challenging assumptions and judgements made by management in their significant accounting estimates (see key audit matters below); and
- Testing of journal entries which contained unusual account combinations back to corroborating evidence.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the country-by-country information. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

A further description of our responsibilities for the audit of the country-by-country information is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report

COUNTRY BY COUNTRY REPORTING

FOR THE YEAR ENDED 31 DECEMBER 2022

Use of this report

This report, including the opinion, has been prepared for and only for the Group and Society's directors in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

The engagement partner responsible for this audit is Daniel Brydon.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
28 February 2023

NOTES

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