TSB Bank plc

Annual Report and Accounts 2022

Registered in Scotland

Company Number: SC095237

TSB Bank plc

Annual report and consolidated financial statements
For the year ended 31 December 2022

Overview

TSB Bank plc (the 'Company'), together with its subsidiary undertakings (together the 'Bank' or 'TSB') offers a range of retail and business banking services in the UK. It is the operating subsidiary of its immediate parent, TSB Banking Group plc, and its ultimate parent company is Banco de Sabadell, S.A.

Contents

Directors and Company Secretary

The Directors who served during the year or until the date of their resignation or from the date of their appointment are:

Chairman:	Nick Prettejohn (independent on appointment)
Executive Directors:	Robin Bulloch (Chief Executive)
	Declan Hourican (Chief Financial Officer)
Independent Non-executive Directors:	Adam Banks
	Elizabeth Chambers
	Lynne Peacock (Senior Independent Director)
	Mark Rennison
	Andy Simmonds
Non-executive Directors:	Leopoldo Alvear (appointed 22 March 2022)
	Marc Armengol (appointed 22 March 2022)
	Carlos Paz (appointed 22 March 2022)
	Alicia Reyes (resigned 21 March 2022)
	Tomás Varela (resigned 21 March 2022)
	David Vegara (resigned 21 March 2022)
Company Secretary:	Keith Hawkins

Registered office:
TSB Bank plc
Henry Duncan House
120 George Street
Edinburgh
EH2 4LH

Strategic report

Review of business performance

Introduction
The Board is pleased with the progress that the business continues to make, particularly in the currently challenging economic environment.

TSB's relentless focus on its customers and delivering its Money Confidence purpose has been instrumental in its response to the cost of living crisis. The successful early execution of the 2019 growth strategy means TSB is in good shape not only to weather this latest economic storm, but also to continue its momentum to be a stronger and better bank.

TSB has delivered another strong year of financial performance and growth. The statutory profit has been impacted by the financial penalty for the 2018 migration event and the Board takes this opportunity to apologise again for the impact this had on the Bank's customers at that time. The actions TSB has taken in the years since to become a truly purpose-led and customer-focused business have created strong foundations for the future. The Bank is now well-placed to draw a line under that difficult chapter in its history.

A refreshed strategy to drive the next stage of TSB's growth has been put in place. This will see the Bank combining the best that digital banking has to offer with a revitalised high-street presence, alongside telephone and video banking, which together provide the all-important human touch when it matters most to customers. Within such a challenging external environment, retail banking remains as competitive as ever, particularly for smaller scale banks like TSB. However, the Board fully supports the level of ambition set out for the coming years and the long-term potential of TSB.

A relentless focus on customers
We continue to make TSB a simpler, more efficient and resilient bank. By multi-skilling more of our colleagues, so they can provide the right support at the first point of contact, we can make it much easier for customers to engage with us, whatever their needs.

In 2022, we have seen evidence that this approach is delivering tangible benefits for our customers:

- We remain the only bank with a Fraud Refund Guarantee, refunding over 97% of customers who are innocent victims of fraud, compared to an industry average of 56%. Four out of five (79%) of fraud victims were refunded within five days or less.
- TSB customers are enjoying the benefits of the Spend & Save account features, with over £36.5 million rounded up into Savings Pots using the 'Save the Pennies' feature on the current account. Active customers were rewarded with £1.3 million in cashback payments while 630,000 customers opened a new savings account, more than double the previous year. In March 2022, we were delighted to win YourMoney.com's 'Best Reward Current Account Provider' award for Spend & Save Plus.
- TSB helped 13,000 first-time buyers get onto the property ladder and supported more than 30,000 customers switching to a new mortgage. TSB continues to deliver a leading mortgage service, with a broker trust rating of 87%, up from 72% at the start of 2021.
- We further strengthened our digital banking offer, improving the look and feel of our internet banking proposition and added more features to our TSB Mobile Banking App. New customers can now open a Spend & Save current account in less than ten minutes through the App, apply for a loan, and switch on card controls. Customers can also access fintech partners such as ApTap, Wealthify and Farewill from their TSB Mobile App.
- A further 84 branches were upgraded in 2022, with nearly all of TSB's branch network now refitted to serve customers better, creating more inviting spaces to engage customers, more self-serve deposit capability and video banking options. While we have reduced our footprint to 220, we have the 7th largest branch network in the country. The branch network is complemented by over 40 'pop-ups' serving communities across Great Britain, and TSB is an active participant in the Cash Access Group Banking Hubs programme.
- Over 2,400 colleagues have completed cost of living training and TSB has established early warning indicators to assist customers before they get into financial difficulty, helping more than 2,300 customers get back on track after struggling with payments. Over 40,000 customers most impacted by the cost of living crisis are contacted regularly offering support and signposting them to the dedicated Money Worries page on TSB's website.
- More than four-fifths (82%) of colleagues believe in TSB's Money Confidence purpose (+13pts compared to 2021). Colleague engagement, the measure we use to gauge how colleagues feel about TSB as a place to work, increased by 10 points over the past 12 months, to 78%.

Review of business performance (continued)

Leadership changes
Following the appointment of Robin Bulloch as Interim Chief Executive in December 2021, the Board unanimously confirmed his appointment on a permanent basis in April 2022. During the course of 2022, a number of changes were made to the composition of the Board. When David Vegara, Alicia Reyes and Tomás Varela stepped down, they were replaced as Non-Executive Directors by Leopoldo Alvear, Carlos Paz and Marc Armengol, each of whom has a strong pedigree in financial services and brings a wealth of banking experience to the Board, alongside a deep understanding of TSB.

Financial Summary
The commercial strength of our business, combined with a focus on customers, digital engagement and operational excellence has contributed to a solid underlying business performance.

TSB has reported a statutory profit before tax of £181.1 million in 2022, a 16.5% increase on the £155.5 million earned in 2021. This reflects strong income growth in an increasing interest rate environment, robust cost management, partially offset by an increase in expected credit loss charges that reflect the more challenging economic outlook. While operating costs, measured on a statutory basis, increased from £827.3 million in 2021 to £869.5 million in 2022, this reflected the payment of £48.7 million of fines following the outcome of the regulatory enforcement review into the Bank's IT migration in 2018 and takes account of conduct related charges of £37.2 million (a year on year increase of £35.0 million). Our efforts to simplify the Bank and become more efficient saw management basis operating costs fall by 2.6% from £797.3 million in 2021 to £776.3 million in 2022.

Growth in both customer lending and deposit balances was solid, but more muted than prior years, and is evidence of management action to navigate the volatile and competitive retail banking markets during the year. TSB remains well capitalised, with a Common Equity Tier 1 (CET1) ratio of 17.1% (2021: 16.0%), and maintains a healthy liquidity buffer with a Liquidity Coverage Ratio of 195.8% (2021: 194.5%). In light of the Bank's capital strength, strong financial performance in 2022 and robust prospects, the Board paid an inaugural dividend of £67 million to its shareholder, TSB Banking Group plc, in December 2022.

TSB's Do What Matters Plan
What a business stands for has never been more important. The customers and communities we serve need confidence that we share their values and consider and support their interests. Consequently, the ability to demonstrate the wider contribution that TSB makes to society is integral to the continued success of our business.

Our Do What Matters Plan, which was launched in 2020, saw TSB set new standards for protecting customers from fraud, lead the field in paying small suppliers promptly, and become the first bank to offer Safe Spaces for victims of domestic abuse in every branch. We were also the first bank accredited by the Good Business Charter. None of this would have been possible without the commitment of colleagues, 88% of whom say they understand their role in delivering the plan. This exceptional level of colleague engagement gives us a strong platform to build further from.

In July 2022, marking the second anniversary of the original plan, we published our Do What Matters 2025 Plan, a key part of TSB's strategy refresh, setting out in more detail what we've achieved so far, and how we will do even more over the next three years to take forward our social and environmental goals. Our 2025 Plan ensures that TSB will play a full part in encouraging financial inclusion, tackling climate change, supporting small businesses to thrive, and championing diversity and inclusion. The bold new commitments reflect the confidence and optimism felt by the Board that we can make a meaningful contribution to millions of customers, the economy and wider society.

For the coming years, we've set ourselves ambitious goals, with measures that meet national and international standards. This includes continuing to make TSB a truly diverse and inclusive place to work, committing to become operationally net zero by 2030, setting science-based targets and supporting our customers in their desire to make greener choices, so we can also transition our financed emissions to net zero by 2050. Additionally, we can play an even greater role in driving financial inclusion for our customers and their communities, as well as helping even more small businesses thrive.

The 2025 plan is built on demonstrating the essentials of responsible business – robust governance, transparent reporting, being a trusted employer, and adhering to regulatory requirements and voluntary codes of practice. This solid foundation enables us to concentrate on a more focused set of key initiatives that reflect where we can best contribute to society and, crucially, connect clearly to our purpose – Money Confidence. For everyone. Every day.

This refreshed approach builds on the best elements of our initial plan, reframing our ambitions under eight goals focused on social and financial inclusion, fair business practices, and supporting a just transition to a greener planet. We want to clearly communicate how we meet the expectations of our customers, colleagues and communities, and the stakeholders who influence them. We've mapped the plan against the United Nations Sustainable Development Goals – a globally recognised framework that helps us focus and evidence the contribution we want to make.

Strategic report (continued)

Outlook and Strategy

Despite the COVID-19 pandemic and the wider economic challenges that have followed, TSB's 2019 growth strategy has been implemented in full, with many of the goals achieved ahead of the three-year plan. We will continue with our focus on improving TSB's digital and service proposition, offering customers better service and more value, while controlling costs, in order to compete effectively in the market.

For TSB's next chapter, we have set out an ambitious plan to take forward our Money Confidence purpose. The strategy has four key areas of focus, centred around service excellence, customer focus, simplification and efficiency and doing what matters for people and the planet.

The regulatory landscape for financial services is also set to undergo important changes in the years ahead with the introduction of the FCA's new Consumer Duty. Our customer focus, high standards of governance and commitment to responsible business practice mean that TSB is well-placed to deliver on this to continue to improve outcomes for customers.

The strategy is set against a fluid economic backdrop. The battle to control inflation while returning the UK economy to a sustainable growth trajectory will be challenging, and it is sensible to anticipate that the continued impact the rising cost of living is having on our customers will also have an effect on the Bank. Our robust capital and liquidity position means that TSB is well placed to navigate these headwinds and continue to support our customers, colleagues and the communities we serve.

Strategic report (continued)

Purpose, business model and key performance indicators

TSB's purpose – Money Confidence. For everyone. Every day.
TSB offers a range of retail banking services and products to individuals and small business banking customers in the UK. TSB has a multi-channel model, including full digital (internet and mobile), telephone and national branch banking service, in addition to a range of new approaches such as video banking, Mobile Money Confidence Experts and pop-ups.

We believe that TSB's multi-channel proposition creates an opportunity to offer superior service to more of our customers more of the time. They want a bank that offers effortless digital tools to service their banking needs and rapid access to skilled people when they need support. TSB continues to invest in developing digital-led products and servicing capabilities that help identify and meet more of our customers' needs now and into the future. This, in turn, improves their confidence in managing their money and ensures we live up to our purpose of Money Confidence. For everyone. Every day.

Business model and key performance indicators
TSB's business model reflects a simple retail banking business and is outlined below:

Component	Description	Financial statements	Key performance indicator
Customer confidence	We seek to deliver a proactive, personalised and effortless banking experience for which customers come to, and remain with, TSB. This will increasingly set TSB apart from other banks and providers of financial services. Central to this is our purpose Money Confidence. For everyone. Every day. which focuses investment in our channels and product proposition so customers are rewarded, protected and always in control.	n/a	**Customer advocacy (Net Promoter Score)** **2022**: **5** / **2021**: **2** **Total digitally active customers** **2022**: **70.7%** / **2021**: 67.8%
Sources of funding and capital	Money deposited by customers into their personal current accounts (PCA) and savings accounts provides the majority of the funds we use to support lending to customers. We also raise funds from other sources, including wholesale markets and central banks, that diversify our funding profile. Our shareholder provides funding in the form of debt and equity capital.	Page 34	**Share of personal bank account gross flow** **2022**: **3.7%** / **2021**: 4.6% **Share of PCA stock** **2022**: **4.0%** / **2021**: 4.2%
Loans and liquid assets	Funds deposited with TSB are used to support lending to customers who wish to borrow. A portion of funds are held in reserve, in the form of a liquidity portfolio, to meet any unexpected funding requirements.	Page 38	**Mortgages gross new lending (£m)** **2022**: **7,037.8** / **2021**: 9,160.4
Income	We earn income in the form of interest that we receive on the loans we make to customers and from our liquidity portfolio. We pay interest to savings and some bank account customers on the money they deposit with us and to providers of other forms of funding. We also earn other income in the form of fees and charges for the provision of other banking services and commissions from the sale of certain products, such as general insurance, offset by fees and rewards paid to certain bank account customers.	Page 50	**Net interest margin** **2022**: **2.57%** / **2021**: 2.44%
Charges	The costs of running the Bank include paying our TSB employees, managing our IT infrastructure, running our branches, investing in our business (such as developing digital opportunities) and paying for marketing. Occasionally, our customers are unable to repay the money they borrow from us; this is also a cost to the Bank in the form of an impairment charge. Finally, TSB complies with its tax obligations to His Majesty's Revenue and Customs (HMRC).	Page 52	**Cost:income ratio (statutory basis)** **2022**: **78.7%** / **2021**: 84.2% **Asset quality ratio** **2022**: **0.14%** / **2021**: 0.00%

Risk management (financial statements on page 57)
Effective risk management underpins TSB's business model. The Board sets an appetite for risk and monitors the risks arising from delivery of TSB's strategy through its business model to ensure the Bank remains liquid, solvent, operationally stable, trusted and compliant. When appropriate, the Board, in turn, will determine whether to return any profits made by the Bank to the shareholder by way of dividend or to reinvest the profit to support the future growth of the Bank.

Strategic report (continued)

Section 172 statement

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

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

The Do What Matters Plan, originally launched in 2020, is TSB's responsible business plan which describes how, through delivery of TSB's purpose and strategy, TSB seeks to contribute to a better society. The Do What Matters Plan has been embedded throughout TSB, with the Board updated regularly on progress. A refresh of the Do What Matters Plan in 2022 re-organised the plan around a simpler framework focused on People and the Planet, with eight goals in total across TSB's four main constituencies of customers, colleagues, suppliers and communities. Collectively these goals will help TSB further social and financial inclusion, fair business practices, and support a just transition to a greener planet.

In reviewing and signing-off on TSB's strategy refresh in the summer of 2022, the Board wanted to better embed the Do What Matters Plan into TSB's strategy, reflecting the importance placed on environmental and societal issues by the Board. Following this recommendation by the Board, doing what matters for people and the planet was included as one of the four key points of TSB's strategy alongside service excellence, customer focus, and simplification and efficiency. The Board discussed the strategy refresh on four separate occasions during the first half of 2022, including at a standalone deep dive session, helping to shape the strategy ahead of ultimate approval by the Board in June.

Customers

The Board takes account of customer experience through regular reviews of key measures such as Net Promoter Score and customer conduct metrics. A particular area of focus for the Board in 2022 was consideration of the FCA's new Consumer Duty, including the impact on TSB and the programme of activity proposed to enhance the delivery of good outcomes for customers. These discussions took place across three Board meetings, with the Board challenging and inputting into management's plans, culminating in the approval of the implementation plan for Consumer Duty in Q4 2022. Alongside consideration of plans for Consumer Duty, a spotlight discussion on vulnerable customers, which continues to be an area of focus for the Board, was also held. As was the case in 2021, the Board also held two 'deep dive' sessions on complaints in 2022 to provide ongoing support and challenge to management's efforts to improve the customer experience through root cause analysis of the main complaint types and to implement action plans to address the underlying causes identified.

In light of the increasing pressure on consumer finances resulting from various macroeconomic factors, there has been an increased focus by management on cost of living impacts on customer finances and behaviour. Visibility of this has been provided to the Board through the sharing of additional credit, savings and arrears data, including the introduction of a Cost of Living appendix to the monthly Chief Risk Officer's Report, which is also considered quarterly by the Risk Committee.

Colleagues

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

- Promoting the role of recognised trade unions in independently representing the interests of employees;
- The appointment of a Board level whistleblowing champion;
- Providing challenge, through the auspices of the Remuneration Committee, to ensure that remuneration policy is appropriate for all employees, as well as executives, and provides for competitive remuneration strongly aligned to the delivery of TSB's strategic goals;
- Undertaking, at least annually, review of talent and succession, particularly in respect of leadership roles within TSB; and
- Considering and interrogating the output from the annual colleague experience survey and additional pulse surveys issued from time to time.

The Board also receives a presentation on an annual basis from The Link to facilitate direct engagement between the Board and employees. The Link is a forum for employees across all levels and all parts of TSB with two regional groups (north and south). It gathers and builds on employee feedback and enables meaningful dialogue between employees, the Executive leadership and the Board on a wide range of topics.

Strategic report (continued)

Section 172 statement (continued)

Colleagues (continued)
Throughout 2022, The Link focused on areas such as the Fraud Refund Guarantee, the TSB strategy refresh, and colleague related matters including colleague experience, reward optimisation and career confidence. The outputs from every meeting of The Link are presented to the Executive Committee to help inform TSB's decision making.

Supported by the Nomination Committee, the Board plays an active role in promoting and challenging progress in establishing a truly diverse and inclusive culture at TSB and carries out succession planning reviews to ensure continuity of skilled employees.

Suppliers
TSB believes that establishing a close relationship with suppliers (including a clear accountability framework) is a pre-requisite for resilient customer services. The Board approves the outsourcing strategy annually, together with any changes to the boundaries of outsourced critical services. Service excellence is a key part of TSB's strategy and, as part of this, TSB will continue to work closely with certain key suppliers.

Communities
The Board also fully recognises its obligations to consider the interests of the wider communities in which TSB operates and this is demonstrated in its support of the Do What Matters Plan. The Board reviewed and supported the 2022 refresh of the Do What Matters Plan and receives regular updates on progress through the Chief Executive's report, as well as a more comprehensive review of progress annually.

Other key stakeholders
The Board also has regard for the interests of the bank's shareholder and regulators as outlined below.

- *TSB's shareholder, Sabadell.* Given Sabadell's 100% ownership of TSB, it is natural that the promotion of the long-term success of TSB, through the development of a clear purpose and strategy, is aligned with the interests of Sabadell. Sabadell's interests are represented at Board by three shareholder appointed Non-executive Directors. Any circumstances where shareholder and TSB interests are not aligned are managed through the disclosure and management of any such potential conflict. Sabadell's interests are further represented through the UK Steering Committee (UKSC). The UKSC seeks to provide Sabadell with a regular overview of the performance of TSB and to ensure that TSB policies and processes are aligned to those of the Sabadell Group where it is appropriate to do so. Certain members of the Bank's Executive Committee are appointed as members of the UKSC.
- *Regulators.* Open and honest engagement with regulators is a cornerstone principle of the UK regulatory environment. The Chief Risk Officer reports regularly to the Risk Committee and the Board on material matters of regulatory liaison and TSB's assessment of the quality of the relationship with each regulator. Certain Board members maintain a direct relationship with the FCA and PRA through the framework of 'proactive engagement and continuous assessment' meetings and report on key themes discussed through committee and Board meetings, as appropriate.

Consideration of environmental and climate change matters
TSB's Do What Matters Plan formalises the Bank's commitment to reducing its impact on the environment while helping customers and employees do the same. As part of this plan, we have committed to reduce our environmental impact and deliver against our goals. In addition, the Board, through regular discussion of the topic at Risk Committee meetings, has engaged with the climate change agenda throughout 2022, inputting into management's plans to recognise and mitigate the risks to the business arising from climate change.

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

Review of financial performance

The Bank's performance is presented on a statutory basis, as explained under the basis of preparation on page 28, and structured in a manner consistent with the key elements of the Bank's business model as explained on page 6.

Income statement	**2022 £ million**	**2021 £ million**
Net interest income	**981.7**	868.9
Other income	**123.8**	114.0
Total income	**1,105.5**	982.9
Operating expenses	**(869.5)**	(827.3)
Impairment	**(54.9)**	(0.1)
Statutory profit before taxation	**181.1**	155.5
Taxation	**(80.5)**	(27.1)
Statutory profit for the year	**100.6**	128.4

TSB's statutory profit before tax for 2022 was £181.1 million compared to a profit before tax of £155.5 million in 2021. The key factors driving the notable year-on-year improvement were:

Income

An increase in total income of 12.5% to £1,105.5 million (2021: £982.9 million), primarily reflecting the impact of lending growth, higher interest rates and deposit margins. This was partially offset by lower mortgage margins in a highly competitive market.

Net interest income increased by 13.0% to £981.7 million. This was primarily due to higher volumes, most significantly in relation to mortgage growth and an increase in net interest margin to 2.57% in 2022 (2021: 2.44%) with higher margins on deposits partially offset by lower margins on mortgage lending. Other income increased by 8.6% to £123.8 million, reflecting higher levels of consumer spending, which resulted in higher interchange income, international payments, and foreign exchange in 2022.

Operating expenses

An increase in operating expenses of 5.1% to £869.5 million (2021: £827.3 million) primarily as a result of the payment of a £48.7 million fine following the conclusion of the joint FCA and PRA investigation into the 2018 IT migration programme. Operating expenses also reflect higher conduct related costs of £37.2 million (2021: £2.2 million). These increases are partially offset by lower levels of restructuring charges compared with 2021 due to a reduction in branch closure activity, and lower management basis operating expenses.

Management basis operating expenses reduced by 2.6% to £776.3 million (2021: £797.2 million) primarily reflecting lower staff and property costs. Employee related costs reduced by 2.7% reflecting ongoing initiatives to simplify the Bank's organisational design, which have contributed to a 4.9% reduction in headcount and reductions in contractor resource, partially offset by inflationary pressure. These cost reductions were partially offset by higher IT servicing and licence fees reflecting recent investment in IT functionality, from cloud infrastructure developments and fraud protection.

	2022 £ million	**2021 £ million**
Management basis operating expenses	**776.3**	797.2
Migration related items[(1)]	**51.1**	0.6
Notable conduct charges[(2)]	**28.6**	2.2
Restructuring costs[(3)]	**11.5**	26.5
Banking volatility[(4)]	**2.0**	0.8
Statutory basis operating expenses	**869.5**	827.3

(1) Comprises of regulatory fines of £48.7 million (2021: £nil), and additional post migration costs of £2.4 million (2021: £0.6 million)
(2) As described in note 29 to the consolidated financial statements on page 81.
(3) Comprises the costs of branch closures and the reorganisation of head office functions (as shown in note 14 on page 53).
(4) Banking volatility reflects volatility associated with share schemes.

Impairment charge

The impairment charge increased in 2022 by £54.8 million from £0.1 million to £54.9 million with the comparison to prior year distorted by COVID-19 related provision releases following lower than expected levels of customer defaults. The higher charge in 2022 also reflects the deterioration in the economic outlook in the form of higher forecast unemployment and interest rates and anticipated falling house prices. A summary of the economic scenarios used for assessing expected credit losses and related scenario weightings is provided in note 8 on page 43.

Strategic report (continued)

Review of financial performance (continued)

Balance sheet, funding and capital

TSB's balance sheet remained strong with the loan to deposit ratio remaining broadly stable, capital ratios increasing, reflecting retained profits, and TSB maintaining liquid assets in excess of regulatory requirements and internal risk limits.

	2022 £ million	2021 £ million
Customer deposits	**36,338.2**	35,951.9
Non-customer funding	**8,119.2**	7,992.5
Borrowings from the Bank of England	**5,538.3**	5,501.6
Debt securities in issue	**1,955.5**	2,199.1
Repurchase agreements	**360.0**	–
Subordinated liabilities	**265.4**	291.8
Shareholder's equity	**1,929.8**	1,866.4
Sources of funding	**46,387.2**	45,810.8
Other liabilities	**3,062.4**	894.8
Total equity and liabilities	**49,449.6**	46,705.6
Loans and advances to customers	**38,050.0**	37,383.8
Liquid asset portfolio(1)	**7,602.3**	7,927.2
Loans and liquid assets	**45,652.3**	45,311.0
Other assets	**3,797.3**	1,394.6
Total assets	**49,449.6**	46,705.6

(1) Comprises balances at central banks of £5,141.2 million (2021: £4,741.5 million) and debt securities of £2,461.1 million (2021: £3,185.7 million). Balances at central banks are combined with cash balances and on demand deposits of £97.6 million (2021: £109.6 million) when shown on the balance sheet on page 30.

Source of funding

- *Customer deposits.* Customer deposits increased by £0.4 billion, or 1.1%, to £36.3 billion, driven by an increase in retail customer deposits of £0.4 billion to £33.6 billion. This reflects strong growth in savings in Q4 when customers benefitted from competitively priced fixed rate products, which more than offset a reduction in current account deposits as the level of customer spending continued to increase following the removal of all COVID-19 restrictions and, more recently, as a result of inflation related cost of living pressures.

- *Non-customer funding.* Non-customer funding increased by £0.1 billion to £8.1 billion, largely reflecting £360.0 million drawn under short term repurchase agreements and the issuance of £250 million of unsecured floating rate notes to TSB's parent company, Sabadell, to satisfy MREL requirements. This was partially offset by the maturity of £500 million of covered bonds.

- *Capital resources*. TSB's capital position has remained above regulatory minimum requirements and internal risk appetite thresholds, with a Common Equity Tier 1 (CET1) capital ratio of 17.1% (2021: 16.0%) and a leverage ratio of 4.2% (2021: 4.1%) on a CRD IV fully loaded basis. In 2022, the increase in CET1 capital ratio primarily reflected retained profits for the year.

Loans and liquid assets

- *Loans and advances to customers*. Loans and advances to customers increased by £0.7 billion, or 1.8%, to £38.1 billion, driven by secured retail lending growth to £35.6 billion. This was partly offset by the expected reduction in the closed Whistletree portfolio. The slower pace of growth in 2022 reflects management action to manage volume in a highly volatile and competitive mortgage market.

- *Liquid asset portfolio*. TSB's liquidity portfolio comprises highly liquid assets, primarily balances deposited at the Bank of England (BOE), UK gilts, development bank bonds, and covered bonds, which are available and accessible to meet potential cash outflows.

  During 2022, the liquidity portfolio decreased by £0.3 billion to £7.6 billion. This reflected a reduction in the carrying value of debt securities of £724.6 million, primary due to higher interest rates. This reduction in the liquidity portfolio was partially offset by higher balances deposited at the BOE. Such balances increased by £399.7 million reflecting a significant increase in cash collateral received from derivative counterparties, offset by amounts required to fund the net growth in customer balances (with growth of £666.2 million in loans and advance to customers, partially funded by higher customer deposits of £386.3 million).

Strategic report (continued)

Principal risks and uncertainties

Approach to risk
TSB seeks to remain liquid, solvent, operationally stable, trusted, and compliant at all times. The objective of TSB risk management is to support and enable these outcomes. The processes to identify, measure and control the risks inherent in its business model are embedded in TSB's risk management framework. TSB's approach to managing these risks is described below. TSB's principal risks and uncertainties are described starting on page 13.

Risk management framework
The risk management framework creates coherent standards and practices for all risk management activities and processes in TSB. The framework is designed around a simple model for categorising risk so that all components of our risk management such as risk appetite, governance, policies, reporting, assurance and organisational design are aligned to the same hierarchy of risks. The five level 1 risk categories which may impact on day to day activities across TSB are shown in the table below.

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

Each of the risk categories also consider the impact of a number of common factors including climate change, regulatory requirements or reputational factors which are referred to as cross cutting risks within the risk management framework.

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

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

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

Strategic report (continued)

Principal risks and uncertainties (continued)

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

The Board measures culture through the Culture Dashboard. This provides insight into TSB's culture against nine traits so that actions can be identified to enhance a high performing environment. Throughout 2022, the culture and employee engagement roadmap has continued to target and strengthen key drivers of customer focus and connection with TSB's purpose, for example through engagement with TSB's strategy refresh.

TSB's Do What Matters Plan has clear commitments to improve the overall diversity of TSB, to better reflect the communities we serve, through the diversity of thinking across the Bank. TSB sets a consistent tone from the top, with senior leaders expected to act as role models for the TSB culture with actions that match their words, as well as encouraging a culture where everyone is safe to share ideas and speak up, including in respect of risk management. The launch and embedding of new TSB Leadership Expectations throughout 2022 has been reinforcing these behaviours.

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

TSB has a clearly defined and proportionate risk appetite that supports its strategy and seeks to provide confidence to its customers, regulators and shareholder. TSB is not a specialist lender and does not seek to differentiate itself as a provider of niche products. At the highest level, TSB aligns its risk appetite to UK mainstream retail banking.

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

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

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

Financial Risk (Asset & Liability Committee)
Chaired by the Chief Financial Officer, the committee is responsible for the strategic management of TSB's balance sheet, the profit and loss implications of balance sheet management actions and the risk management framework for market risk, liquidity risk, capital risk, economic value and financial and prudential regulatory reporting risk.
Credit Risk Committee
Chaired by the Chief Risk Officer, the committee is responsible for the coordination and aggregation of all credit risk management activity, management of TSB's credit risk profile, including credit risk appetite metrics and credit strategies, and TSB's compliance with all relevant credit regulation and legislation.

Strategic report (continued)

Principal risks and uncertainties (continued)

Risk governance (continued)

Operational Risk & Resilience Committee
Chaired by the Customer Delivery Director, the committee is responsible for the aggregation and coordination of operational risk management across TSB, monitoring and challenging the operational risk profile, including key operational risks and controls, and for ensuring appropriate escalation and visibility of relevant breaches, losses and events.
Conduct Risk Committee
Chaired by the Customer Banking Director, the committee is responsible for the aggregation and coordination of conduct risk management across TSB including the delivery of good customer outcomes within risk appetite, compliance with relevant conduct regulation and legislation, monitoring and challenging the conduct risk profile, including key conduct risks and controls, and for appropriate escalation and visibility of relevant weaknesses, breaches, losses and events.
Financial Crime Risk Committee
Chaired by the Chief Risk Officer, the committee is responsible for assessing whether the risk of criminal conduct relating to money or financial services or markets is appropriately managed across TSB. The committee monitors and challenges the financial crime risk profile including key financial crime risks and controls, and ensures appropriate upward escalation and visibility of relevant breaches, losses and events relating to the financial crime risk categories.

TSB uses models in a number of areas of the Bank, most notably in estimating expected credit losses and in calculating the capital impacts of credit exposures. The associated Model Governance Committee, chaired by the Chief Risk Officer, is responsible for the development, implementation and effectiveness of the model governance framework (covering policies, methodologies, systems, processes, procedures and people). This includes articulating the extent and type of model risk to which TSB is exposed, and acting as the Designated Committee as required by the Capital Requirements Regulation.

Principal risks and uncertainties faced by TSB
The Board closely monitors risks that have the potential to materially impact execution of strategy. Over the course of 2022 there has been an increased focus on macro-economic factors to reflect changes in economic conditions as the UK economy emerges from the impact of COVID-19. Additionally, the UK and global markets have been impacted by increased energy costs and the war in Ukraine. These factors have contributed to rates of inflation substantially above Bank of England targets and a series of increases in interest rates to levels not seen for 14 years. It is expected that high inflation and interest rates will continue to contribute to pressures on costs of living for our customers throughout 2023.

Credit performance remains strong and we continue to provide support to our customers through our mission to deliver Money Confidence. For everyone. Every day. In doing so we are confident we will meet the expectations of our regulators and the responsibilities to our customers as detailed in the new Consumer Duty requirements. Our financial stability, operational resilience and customer outcomes are also key themes in the risks considered by the Board throughout 2022 and are detailed below.

Update to principal risks from 2021
Over the course of 2022 our principal risks and uncertainties have evolved from those reported in the 2021 Annual Report. As a result, a number of risks previously reported have been subsumed or replaced by other risks which have come to prominence over the course of the year.

The risks reported in 2021 relating to ‘Threat to profit resilience’ and ‘Risk of sustained or new systemic crisis’ are now referred to in the new ‘Cost of living’ risk. Likewise, elements of the threats posed by ‘Data use, management and security’ reported in 2021 are now reflected as a factor across a number of risks including ‘Execution of strategy’ and as a potential cause of ‘Customer harm’.

Finally, the ‘Increased competition with lack of differentiation’ risk reported in 2021 has reduced in view of the progress made in developing TSB’s position in the market through the establishment of our Money Confidence purpose which will continue to develop in line with the 2022 strategy refresh.

Strategic report (continued)

Principal risks and uncertainties (continued)

New principal risks in 2022

Description	Mitigation
Cost of living	
The outlook for the UK economy remains uncertain as it emerges from the COVID-19 pandemic and as a result of the impact of geopolitical events on the global economy, such as the war in Ukraine. These have led to weaker economic growth, inflationary pressure in the UK and increasing interest rates. These factors have led to a cost of living challenge for our customers with implications for affordability and customer confidence to take on additional borrowing. A sustained challenge could lead to further threats to TSB's strategy and have a negative impact on profitability, capital, funding and liquidity requirements.	To address this risk, TSB has mobilised a multi-disciplinary team to support our Money Confidence purpose. This team is responsible for considering the Bank's response to the emerging cost of living challenge faced by customers; monitoring credit affordability to support sustainable lending; and continued improvement in the management of pre-arrears and customer support measures. In 2022 a dedicated pre-arrears programme has delivered greater support and targeted communications to customers who are showing early signs of struggling with their money. This structured programme will continue into 2023. All portfolios continue to be monitored against agreed risk appetite metrics. Risk appetite in 2023 has been set to reflect the outlook for both inflation and interest rates and will continue to be monitored closely with corrective action taken as appropriate. These include updates to affordability assessment and credit criteria to ensure lending remains sustainable for our customers. Our capital, funding and liquidity requirements will continue to be proactively managed to ensure TSB is able to meet its requirements.
Customer harm	
Delivering fair customer outcomes and preventing customer harm remains a key focus across all business areas. This risk continues to evolve to reflect economic conditions, an ever-changing digital landscape, increased complexity of supplier relationships, and increasing societal and regulatory expectations. For example: • The current economic conditions are likely to lead to changes in customer behaviour and have implications for loan affordability. This will require continued focus on the provision of effective processes and use of data and technology to prevent customer harm. • the Consumer Duty introduced by the FCA, which comes into force in 2023, seeks to address and prevent harm and requires that products and services are fit for purpose and relevant information can be accessed effectively by consumers.	The embedding of our risk management framework and maturing conduct risk management supports the proactive management of potential impacts on customers by identifying where customer harm has occurred or may occur. The Executive Committee and Board receive regular management information on potential and actual customer harm, together with actions taken to prevent harm and address any weaknesses. Considering the developing cost of living crisis, improvements have been made in our practices and strategies for customers in pre-arrears, collections, and recoveries. Our Executive sponsored New Consumer Duty Programme has defined plans and is monitoring implementation and embedding of actions to support compliance with Consumer Duty by July 2023. This has included end to end reviews of customer journeys and the development and enhancement of relevant frameworks so that we can be confident that we are acting to deliver good customer outcomes. We have delivered colleague training to support cultural change and alignment to our purpose of Money Confidence. For everyone. Every day. Furthermore, additional investment has been made available to improve the accessibility of our products and services.

Strategic report (continued)

Principal risks and uncertainties (continued)

New principal risks in 2022 (continued)

Description	Mitigation
Fraud	
There is a risk that TSB fails to protect its customers from becoming victims of fraudulent activity caused by internal or external parties, leading to financial loss, regulatory censure, reputational damage or customer harm.	Our Fraud Excellence plan has focused on developing the maturity of our fraud controls through the identification and closure of control gaps. Further improvement in these controls will be implemented through the Payment Services Regulation (PSR) consultation on protecting customers from Authorised Push Payment (APP) Fraud. Additionally, there will be a focus on the risk of increased fraud activity from organised crime and as a consequence of cost of living pressures.
Climate change	
There is a risk related to climate change, including physical threats, transitional risks, greenwashing, the potential for poor customer outcomes and failing to meet our proposed targets under the Science Based Targets Initiative. With TSB's lending portfolio predominantly comprised of mortgage assets, the main physical risks for TSB are the flooding, subsidence, and coastal erosion (medium and long term) risks associated with security that underpins this loan portfolio. From a transition perspective the main risks arise from the poor energy performance of the properties on which mortgage lending is secured and the risks associated with the cost for improving property energy ratings (short, medium and long-term).	The Planet Steering Committee, established as part of TSB's Do What Matters Plan, oversees the ongoing management of the financial risks from climate change, provides direction on regulatory expectations and considers industry best practice. Regular updates are provided to the TSB Board on progress against the Planet related goals of the Do What Matters Plan. The steps taken by TSB to address the risks and opportunities presented by climate change are more fully documented in the Task Force on Climate-related Financial Disclosures section (see page 15). Mitigants to the risks associated with TSB's mortgage portfolio include our assessment and control of environmental risks at origination; capture of energy performance data; sensitivity and scenario assessments for short, medium and long-term risks; monitoring against climate-related risk appetite metrics; property insurance assessments; Green Further Advance product; and climate-related partnerships.

Strategic report (continued)

Principal risks and uncertainties (continued)

Risks reported in 2021 which continue to be relevant

Description	Mitigation
Maintaining technical and operational resilience	
Disruption to business activities across TSB, and the banking industry, remains a material inherent risk and an area of high importance to our customers and regulators. With the reducing reliance on cash by our customers, the ability to maintain digital services is key and presents a range of risk including disruption to business services, degradation or release of data from cyber-attack, inadequate infrastructure, poor supplier service, technology resilience and operational processing. These may lead to customer detriment, losses through rectifications, remediation costs, or reputational damage.	In line with new regulatory requirements, through 2022 we have established an operational resilience framework that helps us to identify, map, and assess our important business services; enabling identification and remediation of weak points. This includes: dependencies on 3rd parties and the IT applications and infrastructure used to support each service. The framework also includes business continuity, business incident management and operational continuity in resolution, which has provided the opportunity to leverage common activities and data more effectively. In 2023 we will focus on the most critical dependencies, evolve our reporting to monitor the resilience of those dependencies, and enhance our scenario testing capability. Managing cyber risk requires constant focus for TSB and other banks. The external cyber threat landscape is continually evolving and 2022 had seen a rise in the frequency of external attacks and those arising from geo-political events such as the war in Ukraine. TSB maintains strong perimeter controls observed by external benchmarking firms and continues to develop and strengthen internal tools and controls.
Execution of strategy	
In 2022, TSB launched its refreshed strategy. Key aspects of the strategy are to build a deeper relationship with our customers through improved digital and personal service excellence by making TSB simpler and more efficient. Risks to the successful execution of the refreshed strategy include: • Competing high priorities across business functions may result in insufficient technology capacity and change capability to deliver projects on time to meet the needs of our customers and regulatory requirements; • Existing technology infrastructure may not be sufficient to support the new requirements and proposals contained within the refreshed strategy; and • The risk that insufficient data governance could lead to the unavailability or mis-interpretation of data, resulting in poor decision making and customer harm.	A robust portfolio management process is followed, aligning each project to one of the strategic priorities. This will enable effective prioritisation and dependency management across projects and portfolios, aligned directly to delivery of the strategy. New technologies are being embraced to provide greater resilience, availability, and capacity to deliver change. We are continuing to work with our strategic partners to further exploit cloud computing that will enable faster, cheaper, and safer change deployment. The Data Management Framework continues to develop and embed to strengthen capabilities and controls around the collection, use, and quality of data. This will enable data to be used safely to support customer needs.

Strategic report (continued)

Principal risks and uncertainties (continued)

Risks reported in 2021 which continue to be relevant (continued)

Description	Mitigation
Attract and retain talent in a competitive market	
A highly competitive employment market, particularly in a number of specialist fields, continues to provide challenges in recruiting and retaining talent.	TSB seeks to create a diverse and welcoming workplace to reflect the customers and communities it serves across the UK. As outlined in our Do What Matters Plan, TSB seeks to be a trusted employer and to drive performance in a sustainable manner. We work with external resource providers to attract talent, regularly reviewing our reward package to ensure it is both fair and balanced. We provide flexibility on working policies and the geographic location of our colleagues to broaden our potential resource pool. Activities to improve engagement and retention include Career Confidence initiatives to promote internal flow and retention of resource across TSB. Additionally, TSB makes use of redeployment initiatives with a focus on retraining and upskilling of colleagues with a particular focus on developing specialist skills. Efforts have also been made to simplify and increase the transparency of salary growth. Finally, there are clear expectations on our leadership team to connect with colleagues on the refreshed strategy. In addition to the regular annual employee engagement survey conducted in Q4 2022, a survey was carried out in Q2 2022 specifically relating to reward and benefits. As a result, the majority of colleagues have received an improved benefits package and an additional one-off payment to support them in the face of elevated levels of inflation. Future planned activity includes a refresh of our approach to help colleagues to develop future skills.

Emerging risks
TSB regularly considers emerging risks including the likelihood of the relevant risk materialising and the potential impact on our business strategy, customers, employees and shareholder. These risks are considered as part of the business planning cycle.

Longer term divergence in regulations and/or supervisory approach has the potential to emerge as a significant risk for TSB. In addition to UK regulation, TSB is subject to EU regulations and supervisory approaches through its ultimate parent, Sabadell. Whilst there is currently broad equivalence, over time there is a risk that divergence could lead to conflicting requirements which may lead to operational challenges or increased costs. To address this risk TSB actively seeks to manage cross-border compliance risks through effective co-ordination with Sabadell, regular regulatory horizon scanning; appropriate prioritisation of legal, regulatory and mandatory change; and a transparent and pro-active relationship with regulators.

For a large part of 2022 TSB had considered the emerging risks associated with a second Scottish independence referendum. Following the Supreme Court decision in November 2022 that the Scottish Parliament does not have the powers to legislate for a referendum on Scottish independence and that this remains a reserved matter for the UK Government, this risk has receded in the short term. However, we continue to assess the longer term implications which may arise during the next General Election.

Strategic report (continued)

Task Force on Climate-related Financial Disclosures

Introduction

Our climate-related financial disclosures, prepared in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the requirements of PRA's Supervisory Statement 3/19 'Enhancing banks' and insurers' approaches to managing the financial risk from climate change', are set out on pages 18 to 21.

Strategy, risks and opportunities

Climate change risks and opportunities have been considered throughout the strategy refresh and medium term planning process. Our climate change risk assessment and scenario analysis activities have helped inform the strategy and plan, which has enabled us to consider risks and opportunities throughout the process to ensure we remain resilient. TSB has made a number of climate commitments and formed climate related partnerships which are designed to further reduce the carbon emissions from our own operations and baseline the wider environmental impacts of our business and the steps we are taking to help our customers reduce their environmental impact.

Risks

The assessment of the materiality of climate change on all risk categories was updated in 2022. This included the climate impact on TSB (financial materiality) and TSB's impact on the climate (environmental and social materiality). The exercise also included a qualitative impact assessment of climate scenarios, considering potential risks, mitigants and opportunities across all high or medium impacted risk categories using the Climate Biennial Exploratory Scenarios (CBES), issued by the Bank of England, as a guideline. This qualitative analysis is complementary in nature to the more sophisticated quantitative analysis of the residential mortgage portfolio covered below, helping to provide a comprehensive view of potential risks and impacts across a range of potential climate pathways.

For TSB, the financial risks from climate change arise in two main ways, physical risk and transition risk. With TSB's lending portfolio predominantly comprised of mortgage assets:

- The main physical risks for TSB are the flooding, subsidence, and coastal erosion (medium and long term) risks to the potential realisable value of the underlying property related collateral; and
- From a transition perspective, the main risks arise from the poor energy efficiency of properties against which TSB's mortgage lending is secured and the cost of improving property energy ratings (short, medium and long-term).

In light of the emerging and evolving understanding of alternative pathways to a lower carbon UK, our secured lending portfolio has been analysed using detailed risk data that is modelled into a range of scenarios to identify exposure to both physical and transition risks (see Scenario analysis below). We are also impact assessing physical risks for new mortgage lending, which enables us to identify exposures in accordance with our defined risk appetite. We continue to monitor and comply with evolving regulations around climate change.

Scenario analysis

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

TSB has further developed its scenario analysis capability in 2022 to assess the financial impacts of climate change risks on the residential mortgage portfolio. As with 2021, it continues to use the Bank of England's climate scenarios and methodological guidance included in the CBES. Enhancements in the 2022 approach supplements the static balance sheet view with a dynamic balance sheet alternative while offering flexibility of inputs to allow for bespoke business scenarios to be assessed. This represents a significant step forward in capability and should prove invaluable in understanding, and ultimately mitigating, potential risks over the longer term that might threaten TSB's strategic objectives.

The 2022 approach uses TSB's own credit risk and forecasting models, incorporating the physical and transition risks, and macroeconomic assumptions associated with the three CBES scenarios set out below. The models have been designed to forecast losses over a 30-year horizon, adjusting the impact of these risks as they evolve under the scenario narratives.

CBES scenario	Description
Early Action	Carbon taxes and other policies intensify relatively gradually over the scenario horizon. Global CO_2 emissions are reduced to net-zero by around 2050. Global warming is limited to 1.8°C by 2050 relative to pre-industrial levels.
Late Action	The implementation of policy is delayed to 2031 resulting in a more sudden and disorderly transition.
No Additional Action	No new climate policies are introduced. Global warming increases by 3.3°C relative to pre-industrial levels by 2050, leading to chronic changes in precipitation, ecosystems and sea-level.

Strategic report (continued)

Task Force on Climate-related Financial Disclosures (continued)

Scenario analysis (continued)

Results published in the Bank of England's CBES report in June 2022 indicate that TSB is at the lower end of industry estimates for forecast credit losses. The analysis shows that the 'No Additional Action' scenario drives the largest expected credit losses over the 30 year horizon. The effects of flooding being the key driver, driven by very high risk assets becoming uninsurable or unliveable, resulting in reductions in mortgage collateral values. Losses within the 'Late Action' scenario are, again, driven by the same key flooding factors. The 'Early Action' scenario, which drives the lowest forecast losses, resulted in a more even mix between physical risk, such as flooding, and transition risks, such as the impacts that might arise from minimum Energy Performance Certificate (EPC) and energy efficiency regulations.

On the basis of this CBES scenario analysis, it is therefore currently concluded that climate risks do not materially impact TSB's capital position, although ongoing assessments and sensitivity analyses will be undertaken. Scenario analysis will continue to evolve with industry best practice, which alongside cross-functional expertise inputting into the bespoke business scenarios, will deepen our understanding of the climate risks inherent within TSB's business model. This will ensure scenario analysis is embedded in our strategy, risk appetite, financial planning and capital management processes in a manner fully relevant to TSB.

Governance

The Board provides strategic direction on both the Bank's approach to managing the financial risks of climate change and the Do What Matters Plan, using the regular updates and mechanisms described below. The Chief Risk Officer and Chief Financial Officer have responsibility for TSB's approach to managing the financial risks from climate change. This includes the embedding of managing climate change risks within the risk management framework, development of scenario analysis, continued evolution of climate change within the Bank's governance framework and complying with the recommendations of the TCFD. The Risk Committees, as referenced in the Risk Governance section (page 12), maintain a forward-looking view of TSB's risk profile taking into account the financial risks from climate change.

Reporting to the Executive Committee on a quarterly basis as part of the Do What Matters Plan, the Planet Steering Committee provides oversight and direction on the financial risks of climate change and the Do What Matters Plan. This meets every six weeks and is attended by Executive Committee members and members of TSB's wider senior leadership team. Periodic updates are also provided to the Board on all aspects of climate risk.

Risk management

TSB views climate change as a cross cutting risk that manifests through our established risk categories (Financial, Credit, Operational Risk and Resilience, Conduct and Financial Crime). We used our existing risk management framework to assess the impact of climate change across these risk categories by determining where the largest impacts would emerge (see risk section above) and assessing the impact on controls, policies and risk appetite measures.

By using our existing, established risk management framework the significance of climate-related risks has been assessed in comparison to other risks. The assessment of climate-related risks has been integrated with the bank's six-monthly risk and control assessment and is considered within the annual risk appetite review. Further detail on these measures can be found within the Metrics and targets section on page 20. The TSB policy framework, a key component of the risk management framework, requires climate change to be considered within the annual policy review process. This includes documenting an assessment of how climate change may influence each policy as part of the policy effectiveness statement.

As TSB's credit portfolio is significantly weighted towards secured lending an assessment of the physical and transitional risks associated with climate change has been completed with a focus on the impact of the physical risks from flooding, subsidence and coastal erosion on the mortgage portfolio (medium to long term risks). In doing so, consideration of the impact on customers of the withdrawal of Floodre (a joint initiative between the UK Government and insurers to provide affordable flood cover insurance to consumers) in 2039 has been considered.

Consideration is being given to initiatives that will provide support to customers in properties with poor EPC ratings to reflect the impact of transitional risks on our secured portfolio. Activity has focused on a continuation of TSB's Green Further Advance product to support customers looking to improve the energy efficiency of their homes; and further investment in a programme of works to decarbonise TSB's property estate to support our commitment to reduce operational emissions to net zero by 2030. Preparatory activity for the future issue of green, social or sustainable bonds to support the development of other green products has also been completed in 2022.

Strategic report (continued)

Task Force on Climate-related Financial Disclosures (continued)

Risk Management (continued)

Initial training was delivered in 2022 to provide all colleagues with an understanding of climate related risks and opportunities and how these are managed within TSB. In 2023 it is planned to deliver further focused training to all risk category owners. This training will focus on key climate change considerations, the impacts on banks and regulatory expectations. In doing so we expect to ensure our risk management approach continues to keep pace with evolving industry standards and emerging good practice.

Metrics and targets

Recognising the importance of measuring and tracking climate related metrics to meet regulatory requirements and support the Do What Matters Plan, TSB is seeking to enhance its reporting capabilities in early 2023. To achieve this, TSB is planning to deploy a climate data platform to support the reporting of climate related management information to all relevant committees and business areas. This platform will support the monitoring of emission reductions and future responsible business disclosures.

Our risk appetite defines the amount and type of risk we are willing to take in pursuit of our strategy. In setting our risk appetite measures for 2023, consideration was given to climate change in line with the goals of TSB's Do What Matters Plan and net zero objectives by 2030. The risk appetite measures for 2023 focus on the EPC rating of our secured portfolio, together with monitoring those properties at higher risk of flooding. Additionally, in 2023, we will continue to embed appetite measures for the environmental impact of our suppliers and emissions from TSB properties (e.g. branches and offices).

Risk appetite measures in 2023 will continue to monitor and assess the physical and transitional climate risks associated with our mortgage book through reporting of the mortgage portfolio analysed across EPC ratings and flood risk indicators. The tables below provide data in respect of the EPC ratings and financed emissions of the properties provided as collateral for mortgage lending.

Gross loans and advances to customers (Secured retail) by EPC rating	2022 £ million	2021 £ million
A (Very energy efficient – lower running costs)	**49**	52
B	**3,029**	2,958
C	**5,424**	5,835
D	**9,136**	9,903
E	**3,064**	3,371
F	**582**	624
G (Not energy efficient – higher running costs)	**124**	135
Unknown(1)	**14,247**	11,956
Total	**35,655**	34,834

(1) Increase in unknown driven by (i) remortgages, where an EPC rating was not required, (ii) expired EPC ratings, and (iii) new build properties where the mortgage was offered before the EPC assessment. For new builds, this is a timing issue, and data is obtained subsequently once the EPC register is updated.

Financed emissions (tCO2e) by EPC rating	2021 tCO2e	2020 tCO2e	2019 tCO2e
A (Very energy efficient – lower running costs)	114	89	74
B	16,402	14,231	11,694
C	82,333	77,935	74,592
D	241,504	246,950	242,284
E	111,437	113,368	110,845
F	28,298	28,349	27,853
G (Not energy efficient – higher running costs)	8,115	8,091	7,884
Absolute carbon emissions from TSB core residential mortgage portfolio (scope 3)	488,203	489,013	475,226
Economic intensity (tCO2e per £ million of lending and investment portfolio)	16.61	19.06	19.84

Emissions from lending and investment portfolios form a considerable part of TSB's Scope 3 emissions. The table above displays the results of preliminary emissions calculations utilising the Partnership for Carbon Accounting Financials (PCAF) methodology with a data quality score of 3.25 (2021 financed emissions). This calculation is based on our core residential mortgage portfolio with available data which forms 74% of TSB's total lending and investment portfolio in 2021. Due to the complexity in compiling this data, it is disclosed on a one year lag.

Task Force on Climate-related Financial Disclosures (continued)

Metrics and targets (continued)

TSB has also set risk appetite measures to monitor the reduction in the environmental impact of TSB's key suppliers. The measures will utilise data provided by suppliers on environmental questions with oversight provided by TSB's Procurement team in their Environment, Social and Governance due diligence reviews. This measure will be reviewed in 2023 to ensure alignment with TSB's proposed Science Based Targets for Scope 3 Purchased Goods and Services emissions.

It is proposed to focus on key Science Based Targets covering Scope 1 and 2 which includes emissions from property, company cars, and renewable energy and provide a starting point for reporting financed emissions from corporate real estate loans once an emissions baseline has been established. These measures were agreed in late 2022 and are expected to be validated by the Science Based Targets Initiative in 2023.

Taken together, these risk appetite measures are aligned to the goals and objectives set out by the Planet Steering Committee to support the Do What Matters Plan and delivery of TSB's goals in a sustainable manner.

Environmental information

Doing what matters for the environment is a growing concern for our customers, colleagues, and other stakeholders we work with, including regulators. Our Do What Matters 2025 plan focuses on rapidly reducing our impact on the environment, contributing to the Paris Agreement and helping our customers and colleagues to make meaningful and impactful sustainable decisions.

Our goals are focused on reducing our impact on the environment and helping our customers and colleagues to do the same. Our environmental strategy considers emissions from our own operations (Scope 1 and 2 greenhouse gas emissions) as well as our upstream and downstream impacts, for example, from our mortgage lending products and supply chain (Scope 3 greenhouse gas emissions).

In 2022, TSB restated our commitment to achieve net zero emissions from our own operations (Scope 1 and 2 greenhouse gas emissions) by 2030, through the publication of our Do What Matters 2025 Plan.

Summary of Streamlined Energy and Carbon Reporting (SECR)

The table below reflects TSB's greenhouse gas emissions as required by the UK Streamlined Energy and Carbon Reporting (SECR) Regulations for a 'large unquoted organisation'. The data has been compiled in accordance with the GHG Protocol Corporate Accounting and Reporting Standard.

TSB appointed Ernst and Young LLP (EY) to provide limited independent assurance over the 2022 KPIs (as indicated by (*) in the table below) for the year ended 31 December 2022. The assurance engagement was planned and performed in accordance with the International Standard for Assurance Engagement (ISAE) (UK) 3000 (July 2020) Assurance Engagements Other than Audits or Reviews of Historical Financial Information. A limited assurance report was issued and is available on the TSB website. This report contains details of the scope, respective responsibilities, work performed, limitations and conclusion. Further information on TSB's methodology and full SECR reporting table can be found at https://www.tsb.co.uk/files/tsb-secr-methodology3.pdf. TSB's total energy consumption, as measured on a location[(1)] basis, reduced by 24% in 2022 compared to 2021.

Summary of Streamlined Energy and Carbon Reporting	2022	2021	2020[(8)]	2019[(8)]
Emissions – Location-based [(1)] in gross tonnes of carbon dioxide equivalent (tCO2e[(2)])				
Scope 1 emissions from the combustion of fuel and operation of facilities [(3)]	**1,669***	2,174	2,044	2,150
Scope 2 emissions from the purchase of electricity [(4)]	**2,958***	4,271	4,302	5,528
Total scope 1 and 2 location-based emissions	**4,627***	6,445	6,346	7,678
Scope 3 emissions from business travel, waste, water and paper [(5)]	**925***	757	1,397	2,935
Total Scope 1, 2 and 3 location-based emissions	**5,552***	7,202	7,743	10,613
Intensity ratio (tCO2e per FTE) [(6)]	**1.0***	1.2	1.4	1.8
Energy consumption kWh (million) [(7)]	**23.844***	31.411	29.977	32.270

(1) Location-based emissions are those measured using the UK national grid electricity conversion factors, updated annually.
(2) tCO2e – tonnes of carbon dioxide equivalent.
(3) Scope 1: gas, heating oil, fugitive gas, and company cars. Oil data has been revised for 2019 to 2021 to reflect updated consumption data.
(4) Scope 2: direct commercial electricity supplies plus landlord data where available.
(5) Scope 3: financed emissions in respect of TSB's mortgage lending are set out on page 20.
(6) Calculated as the sum of Scope 1, 2 and 3 location-based emissions divided by the average annual headcount.
(7) Scope 1, 3, and energy consumption totals include both mandatory and voluntary elements of SECR reporting.
(8) 2019 and 2020 figures have been re-baselined to account for site closures between 2019 and 2021 in line with TSB's re-baselining policy.

Strategic report (continued)

Environmental information (continued)

Summary of Streamlined Energy and Carbon Reporting (SECR) (continued)

The table below reflects TSB's net operational emissions (Scope 1 and 2) after accounting for the purchase of REGO certified renewable electricity and Plan Vivo verified carbon removal credits. In 2022, compared to our 2019 re-baselined position, Scope 1 and 2 market-based emissions reduced by 73% to 1,669 tonnes of carbon dioxide equivalent (tCO2e). Scope 3 emissions have reduced by 68% compared to 2019. These reductions were due to implementation of paperless processes and a longer-term adoption of hybrid working following the pandemic.

TSB greenhouse gas emissions data	2022	2021	2020[9]	2019[9]
Emissions – Market-based[1] in gross tonnes of carbon dioxide equivalent (tCO2e[2])				
Total Scope 1 and 2 emissions[3]	**1,669**	2,174	2,044	6,103
Verified carbon removals (offsets)[4]	**(1,669)**	(2,171)	(2,761)	–
Net Scope 1 and 2 market-based emissions[5]	**–**	3	(717)	6,103
Total Scope 3 operational emissions tCO2e[6]	**925**	757	1,397	2,935
Total	**925**	760	680	9,038
Resource consumption data				
Paper (tonnage) [7]	**445**	583	984	1,439
Water (m^3)	**39,289**	47,238	50,215	66,398
Waste (tonnage) [8]	**839**	1,200	1,450	1,283
Waste Diverted from Landfill	**99.6%**	99.7%	99.4%	97.1%
Waste intensity (waste tonnage per FTE)[10]	**0.15**	0.20	0.21	0.17

(1) Market-based emissions are those associated with the purchase of REGO certified renewable energy which carry zero-rated emissions. TSB began purchasing REGOs in October 2019.
(2) tCO2e – tonnes of carbon dioxide equivalent.
(3) Scope 1 and 2 emissions: Natural gas, fugitive gas, heating oil, company cars, electricity (100% REGO certified). Oil data has been revised for 2019 to 2021 as updated consumption data was received for these years.
(4) Plan Vivo carbon removal certificates registered on the Markit Environmental Registry.
(5) Net Scope 1 and 2 emissions are total market-based emissions minus verified carbon removals.
(6) Scope 3 location-based operational emissions include: Business travel (air travel, train, hotels, rental cars and employee-owned vehicles where TSB is responsible for purchasing the fuel), waste, water and paper consumption.
(7) Paper: Total tonnage arising from office and branch paper purchases, print and mail and marketing activities.
(8) Waste: Total tonnage arising from office and branch waste, destruction of archived documents, recycling of IT equipment and project waste including activity from the Branch Closure Programme (BCP).
(9) 2019 and 2020 figures have been re-baselined to account for site closures between 2019 and 2021 in line with TSB's re-baselining policy.
(10) Calculated as the tonnes of waste generated divided by the average annual headcount.

TSB continues to procure 100% renewable electricity, which has contributed to an overall reduction in scope 1 and 2 market-based emissions of 73% in 2022 when compared to 2019. TSB is committed to continuing to purchase renewable electricity, alongside plans to explore other bio-fuels and reduce overall energy consumption.

In 2022, our Energy Optimisation programme was launched, with the formation of an Energy Management team within our facilities management provider. This programme will involve a site-by-site review of all energy reduction opportunities, with a view to implementing improvements across our estate over the coming years.

Our LED replacement programme completed this year, which replaced older, inefficient light bulbs with more energy efficient LED versions. We have already seen a reduction in reactive jobs to replace lightbulbs and we continue to monitor the reductions in energy use and associated cost savings.

In October, we launched a new Energy Efficiency training module for colleagues, to compliment and build upon our existing 'Do What Matters for the Environment' training. The new module aims to educate colleagues on energy wastage and equip them with practical tools to reduce energy consumption in the workplace and at home.

Our green colleague network has continued to grow in 2022, with an uplift in colleagues now engaging with our 'Green Team' Yammer pages. Alongside knowledge and idea sharing, this group held focus sessions throughout 2022, featuring themes such as less waste cooking, green travel, fast fashion, pensions and energy efficiency. Our Green Team were also actively involved in partnership pilots, shortlisting for external sustainability awards and online and on-site activities during Recycling Week (which our facilities management provider also supported with new bin signage and demonstrations of contaminated waste).

Recycling remains a key area of focus for TSB, and we reconfirmed our ambition to achieve a stretching 90% recycling target in our refreshed Do What Matters Plan this summer. For 2022, our overall recycling rate was 79%, so we continue to explore ways to engage with our colleagues and suppliers and make this a key area of focus in 2023.

A continued focus on removing paper from our operations meant that our existing target was achieved and emissions from TSB paper consumption in 2022 were 69% lower than in 2019.

Strategic report (continued)

Environmental information (continued)

Summary of Streamlined Energy and Carbon Reporting (SECR) (continued)

Our target to maintain business travel at below 50% of 2019 volumes was achieved, despite colleagues returning to offices more frequently in 2022. Our overall business travel emissions for 2022 were 32% of 2019 volumes. We continue to support hybrid ways of working and promote alternative modes of transport to maintain this reduction.

TSB offers only fully electric cars to colleagues who are eligible for the company car scheme and 79% (2021: 67%) of the TSB fleet is now fully electric. In 2023, we will explore enhancements to facilities to support active travel.

In 2022, TSB developed and submitted a proposed suite of targets to the Science Based Targets initiative (SBTi) and, at the date of this report, await SBTi validation. We worked with an external consultancy to evaluate our 2019 base year emissions and with input from across the business, set targets across key emissions areas. As part of this project, and in line with our re-baselining strategy, TSB has restated 2019 and 2020 emissions figures in this report, to reflect branch closures that took place in the 2020-2021 period; this has led to an overall reduction in our base year emissions.

Looking ahead to 2023, we are also preparing to set interim targets through our membership of the Net Zero Banking Alliance (NZBA). NZBA is an industry led, United Nations convened global group of banks committed to aligning their lending and investment portfolios with net zero emissions by 2050. Signatory banks must set intermediate targets for 2030 or sooner using science-based guidelines.

We are currently in the process of selecting a supplier for a centralised climate data platform, to be implemented in 2023. This will allow TSB to focus on data-driven decisions, by expanding on our emissions dataset and further improving the quality and controls around our climate data, placing TSB in a resilient position to tackle the many challenges posed by climate change.

To support the Do What Matters Plan 2025, and to demonstrate our long-term commitment to protecting the environment, TSB created a Sustainability team in 2022. This team co-ordinates a Planet Working Group to drive sustainability actions across the organisation. Through the creation of these permanent roles, TSB can embed sustainability and drive meaningful change at all levels of the business.

Strategic report on pages 3 to 23 approved, by order of the Board

Keith Hawkins
Company Secretary
31 January 2023

Directors' report

Introduction
The Directors of TSB Bank plc (the 'Company') present their report and audited financial statements for the year ended 31 December 2022, in accordance with section 415 of the Companies Act 2006. The Colleagues and Suppliers sections of the Section 172 statement (pages 7 and 8), and the Summary of Streamlined Energy and Carbon Reporting on pages 21 to 23 is incorporated into this Directors' report.

Principal activities and results
The principal activities and review of the Company are set out in the Strategic report on pages 3 to 23.

Dividends
The Directors paid an interim dividend of £67 million in 2022 (2021: nil). The Directors do not propose to pay a final dividend.

Directors
The Directors who served during the year are shown on page 2.

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

With the exception of the Directors appointed during 2022, the indemnities were in place throughout 2022. The indemnities for Leopoldo Alvear, Marc Armengol and Carlos Paz were executed on 24 March 2022. Each of the indemnities remain in force at the date of signing these financial statements and are available for inspection at the Company's registered office.

Corporate governance
Although the Company does not have shares with a premium listing on the London Stock Exchange, and does not need to comply with the UK Corporate Governance Code (Code), the Board has chosen to voluntarily adopt those principles of the Code that are considered appropriate for the Company. Information on how the Company has applied the Code can be found starting on page 36 of the annual report and accounts of the Company's parent, TSB Banking Group plc, which is available at www.tsb.co.uk. TSB Banking Group plc's annual report and accounts also contains further information on the Company's governance arrangements including reports from TSB's Nomination Committee and Audit Committee.

Future developments
The development of the Company is set out in the context of the Company's business model on page 6.

Employee information
We're making good progress towards having a truly diverse workforce that reflects the UK working age population by 2025. In 2022, the number of senior roles held by women increased to 42% (2021: 41%), above the industry average of 36%. Asian and Minority Ethnic representation in senior roles also increased, with Black, Asian and Minority Ethnic representation reaching 11% (2021: 9%).

We introduced a Black Talent plan in 2022 and, overall, this has seen Black workforce representation increase to 1.8% (2021: 1.6%) of colleagues who have shared their ethnicity data, with a target to achieve 3% by the end of 2025.

We are proud to be signatories to the Black Talent Charter. This commits to creating and maintaining an environment where Black talent can be identified, developed and promoted for the benefit of individuals and the organisation, supporting the recruitment of Black employees and their development and progression into senior roles in the financial and professional services sectors by focusing on the entire executive pipeline, and reporting publicly on actions and progress.

We launched our new Ignite programme to support Black and Black mixed-heritage colleagues to progress their career at TSB. We also welcomed 17 new interns as part of the 10,000 Black Interns programme, with five colleagues subsequently joining TSB permanently.

Our gender balance, combined with inclusion activities, such as the undernoted gender neutral parental leave policy, saw us recognised as a Times Top 50 Employer for Women.

We are one of the first banks to introduce equal parental leave, giving all parents, regardless of gender, equal leave with their child. Offering this to our employees helps us to challenge gender stereotyping when it comes to parenting as our equal parental leave gives all parents equal time to care for their new child.

We promote an inclusive workplace environment with particular emphasis on trans and non-binary issues and education, and in 2022 have been recognised as one of Stonewall's Top 100 employers for LGBTQ+ colleagues, as well as being classed as a gold standard employer.

Directors' report (continued)

Employee information (continued)
To develop a truly inclusive culture we continue to support an intersectional Inclusion network with executive level sponsors for TSB Ability, Ethnicity, Gender Balance and LGBTQ+. These networks actively challenge and contribute to diversity and inclusion plans by hosting conversations with colleagues throughout the year on topics such as career confidence for women, non-visible disabilities, transgender awareness and Black History Month. 93% of colleagues agree that TSB promotes an inclusive work environment that accepts everyone's individual differences.

TSB achieved Level 3 accreditation and became a Carer Confident Ambassador employer demonstrating the level of commitment shown at TSB to build an inclusive and supportive workplace for carers and continuing to be the only bank that offers colleagues paid leave when they need it.

In July, we announced support for over three-quarters of colleagues impacted by the increased cost of living providing an additional payment of £500 in October 2022 with a further £500 to be paid in February 2023.

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

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

Involvement of employees in business / consulting with employees
Collaborative and honest dialogue is encouraged at all levels to promote the involvement of every employee in the business. This includes TSB's employee forum, The Link, which has met five times in 2022, providing a direct connection between employees, the executive leadership and the TSB Board. We also continue to work closely with our recognised unions, Accord and Unite, on key focus areas including financial support and wellbeing, total reward and pay, inclusive policies and organisational change and redeployment.

TSB's annual colleague experience survey provides employees with the opportunity to feedback on working at TSB, with a roadmap developed to address the key findings. TSB has seen a 10 percentage point increase in engagement levels in 2022 from 68% to 78%.

In 2022 colleagues were given the opportunity to feedback on the make-up of their total reward package through an all employee survey. Based on this feedback we have started to change the total reward of three in four colleagues from January 2023.

We recognise and celebrate the contribution and behaviour of colleagues. During 2022, more than 113,000 recognitions were awarded through the Spotlight programme that gives colleagues the opportunity to recognise exceptional contributions from fellow employees.

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

Political donations and expenditure
No amounts were given for political purposes during the year (2021: £nil).

Financial instruments
Information on financial risk management objectives and policies in relation to the use of financial instruments can be found starting on page 57 of the financial statements.

Principal risks and uncertainties
The principal risks and uncertainties faced by the Company are set out starting on page 11.

Post balance sheet events
There are no significant events affecting the Company that have arisen between 31 December 2022 and the date of this report that require disclosure.

Directors’ report (continued)

Research and development activities
The Company develops new products and services during the ordinary course of business.

Overseas branches
The Company does not have any branches outside of the United Kingdom.

Registered office
The registered office address for TSB Bank plc is Henry Duncan House, 120 George Street, Edinburgh, EH2 4LH.

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

Appointment of external auditor
The audit of the 2022 financial statements is the third to have been undertaken by KPMG following a competitive tender undertaken in 2018 for the audit of the 2020 financial statements. Pamela McIntyre was the senior statutory auditor for the audit of the 2022 financial statements, her third audit of TSB’s financial statements.

A resolution to re-appoint KPMG for the audit of the financial statements for the year ending 31 December 2023 will be proposed at the 2023 Annual General Meeting.

Going concern
The Directors recognise their responsibility to make an assessment of TSB’s ability to continue as a going concern, for a period of at least 12 months from the date the financial statements are approved. The Directors’ assessment of going concern is integrated with the assessment of the viability of TSB. The Directors, having taken into account the matters noted in the ‘Basis of preparation’ on page 28, are satisfied that adequate funding, liquidity and capital resources will be in place to allow the financial statements to continue being prepared on a going concern basis and are not aware of any material uncertainties that may cast significant doubt upon TSB’s ability to continue as a going concern.

Viability assessment
The Directors’ assessments of viability and principal and emerging risks can be found on page 52 of the annual report and accounts of the Company’s parent, TSB Banking Group plc, under the heading ‘viability statement.’

Statement of directors' responsibilities in respect of the financial statements
The Directors are responsible for preparing the annual report and the consolidated (Bank) and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare the Bank and Company financial statements for each financial year. Under that law they are required to prepare the consolidated financial statements in accordance with UK adopted international accounting standards and applicable law.

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

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

Directors' report (continued)

Statement of directors' responsibilities in respect of the financial statements (continued)

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

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

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

By order of the Board

Keith Hawkins
Company Secretary,
31 January 2023

Financial statements

Basis of preparation
These consolidated financial statements of TSB Bank plc comprise the results of TSB Bank plc (the 'Company'), a public limited company, limited by shares, consolidated with those of its subsidiaries, (together the 'Bank'). Details of subsidiary undertakings are provided in note 24 to the financial statements on page 79. These consolidated financial statements have been prepared in accordance with UK adopted international accounting standards.

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

Going concern
The going concern basis is dependent on maintaining sufficient capital and funding. The Directors considered a number of factors including an assessment of principal risks and projections of capital, funding and liquidity. TSB's business activities and objectives, together with the factors likely to affect its future development, performance and position are set out in the Strategic report. In 2022, TSB reported a profit before tax for the year of £181.1 million (2021: £155.5 million) and continues to be in compliance with, and exceeds, its regulatory capital and liquidity requirements.

As part of those forecasts, the Directors have modelled the impact of a severe but plausible downside stress in line with the severe downside scenario described in note 8, which is a scenario used in the Bank's ICAAP process and is broadly consistent with the Bank of England's stress scenario. Based on the forecasts and the stress performed, the Directors are satisfied that TSB will have sufficient regulatory capital and liquidity for a period of at least 12 months from the date of approval of these financial statements. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Accounting policies
The significant accounting policies used in the preparation of the consolidated financial statements are consistent with those applied in 2021. The accounting policies are presented in a manner consistent with TSB's business model and are included in the relevant sections of the consolidated financial statements. In addition, the following accounting policies relate to the consolidated financial statements as a whole.

- Consolidation - Subsidiaries are all entities (including special purpose entities) over which the Company has control. The Company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company and are deconsolidated from the date that control ceases. Inter-company transactions, balances and unrealised gains and losses on transactions between group entities are eliminated.
- Foreign currency translation - Foreign currency transactions are translated using the exchange rates prevailing at the date of the transaction. Monetary items denominated in foreign currencies are translated at the rate prevailing at the balance sheet date. Foreign exchange gains and losses resulting from the restatement and settlement of such transactions are recognised in other operating income in the income statement.

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

Index to the financial statements

The Bank's primary financial statements are presented on pages 30 to 33. The notes to these financial statements are structured to follow the Bank's business model as set out on page 6 and are listed below.

Balance sheets

as at 31 December 2022

	Note	Bank (Consolidated) 2022 £ million	Bank (Consolidated) 2021 £ million	Company 2022 £ million	Company 2021 £ million
Assets					
Financial assets at amortised cost:					
Cash, cash balances at central banks and other demand deposits		**5,238.8**	4,851.1	**5,238.8**	4,851.1
Debt securities	6	**1,951.6**	2,166.7	**1,951.6**	2,166.7
Loans and advances to customers	8	**38,050.0**	37,383.8	**38,050.0**	37,383.8
Loans and advances to central banks and credit institutions	7	**303.5**	199.7	**144.3**	143.6
Other advances	9	**703.2**	80.7	**703.2**	80.7
Financial assets at fair value through other comprehensive income					
Debt securities	6	**509.5**	1,069.0	**509.5**	1,069.0
Financial assets at fair value through profit or loss					
Derivative financial assets not in hedge accounting relationships	21	**1,158.7**	168.4	**1,073.2**	168.4
Hedging derivative financial assets	21	**1,565.9**	244.5	**1,565.9**	244.5
Fair value adjustments for portfolio hedged risk	21	**(542.8)**	(109.3)	**(542.8)**	(109.3)
Property and equipment	25	**287.5**	300.3	**287.5**	300.3
Intangible assets	27	**75.6**	72.1	**75.6**	72.1
Deferred tax assets	17	**64.5**	122.6	**64.5**	122.6
Other assets	28	**83.6**	156.0	**322.8**	212.1
Total assets		**49,449.6**	46,705.6	**49,444.1**	**46,705.6**
Liabilities					
Financial liabilities at amortised cost:					
Customer deposits	1	**36,338.2**	35,951.9	**36,338.2**	35,951.9
Borrowings from central banks	2	**5,538.3**	5,501.6	**5,538.3**	5,501.6
Debt securities in issue	2	**1,955.5**	2,199.1	**1,955.5**	2,199.1
Repurchase agreements	2	**360.0**	-	**360.0**	-
Subordinated liabilities	3	**265.4**	291.8	**265.4**	291.8
Lease liabilities	26	**145.9**	163.5	**145.9**	163.5
Other financial liabilities	4	**1,320.1**	193.6	**1,320.1**	193.6
Financial liabilities at fair value through profit or loss:					
Derivative financial liabilities not in hedge accounting relationships	21	**1,252.4**	156.5	**1,252.4**	156.5
Hedging derivative financial liabilities	21	**301.5**	136.8	**301.5**	136.8
Fair value adjustments for portfolio hedged risk	21	**(321.3)**	(63.6)	**(321.3)**	(63.6)
Provisions	29	**125.0**	110.2	**125.0**	110.2
Other liabilities	30	**238.8**	197.8	**238.4**	197.8
Total liabilities		**47,519.8**	44,839.2	**47,519.4**	44,839.2
Equity					
Share capital	22	**79.4**	79.4	**79.4**	79.4
Share premium	22	**195.6**	195.6	**195.6**	195.6
Other reserves	22	**412.8**	412.8	**412.8**	412.8
Retained profits:					
Retained profits brought forward	22	**1,174.1**	1,045.7	**1,174.1**	1,045.7
Profit attributable to the shareholder for the current year	22	**100.6**	128.4	**95.5**	128.4
Dividend paid		**(67.0)**	–	**(67.0)**	–
Fair value reserve	22	**(6.1)**	11.1	**(6.1)**	11.1
Cash flow hedging reserve	22	**40.4**	(6.6)	**40.4**	(6.6)
Shareholder's equity		**1,929.8**	1,866.4	**1,924.7**	1,866.4
Total equity and liabilities		**49,449.6**	46,705.6	**49,444.1**	46,705.6

The accompanying notes are an integral part of the consolidated financial statements. No statement of comprehensive income has been shown for the Company, as permitted by section 408 of the Companies Act 2006. The consolidated and Company financial statements on pages 30 to 85 were approved by the Board of Directors on 31 January 2023 and signed on its behalf by:

Robin Bulloch
Interim Chief Executive

Declan Hourican
Chief Financial Officer

Consolidated statement of comprehensive income

for the year ended 31 December 2022

Income statement (continuing operations):	Note	Bank 2022 £ million	Bank 2021 £ million
Interest and similar income:			
Interest income calculated using the effective interest method	11	**1,123.0**	946.4
Other interest income/(expense)	11	**108.7**	(35.0)
Total interest and similar income		**1,231.7**	911.4
Interest and similar expense	11	**(250.0)**	(42.5)
Net interest income	11	**981.7**	868.9
Fee and commission income	12	**135.5**	121.8
Fee and commission expense	12	**(21.3)**	(18.2)
Net fee and commission income	12	**114.2**	103.6
Net gains/(losses) on financial assets and liabilities:			
Gains on derecognition of financial assets measured at fair value through other comprehensive income		**6.3**	7.0
Losses on derivative financial assets at fair value through profit or loss		**(8.1)**	(2.5)
Gains/(losses) from hedge accounting	21	**4.2**	(2.4)
Gains/(losses) on derecognition of non-financial assets		**0.6**	(2.6)
Other operating income	13	**6.6**	10.9
Other income		**123.8**	114.0
Total income		**1,105.5**	982.9
Total operating expenses	14	**(869.5)**	(827.3)
Operating profit before impairment losses and taxation		**236.0**	155.6
Impairment losses on financial assets at amortised cost	18	**(57.7)**	(2.6)
Impairment credit on loan commitments	29	**2.8**	2.5
Total impairment losses		**(54.9)**	(0.1)
Profit before taxation		**181.1**	155.5
Taxation	16	**(80.5)**	(27.1)
Profit for the year	22	**100.6**	128.4
Other comprehensive income/(loss):			
Items that may be subsequently reclassified to profit or loss:			
Change in fair value reserve:			
Change in fair value	21	**(17.3)**	6.2
Transfers to the income statement	21	**(6.3)**	(7.0)
Taxation thereon	17	**6.4**	0.3
	22	**(17.2)**	(0.5)
Change in cash flow hedging reserve:			
Change in the fair value of derivatives in cash flow hedges	21	**63.5**	24.0
Transfers to the income statement	21	**1.7**	(5.4)
Taxation thereon	17	**(18.2)**	(5.0)
	22	**47.0**	13.6
Other comprehensive income for the year, net of taxation		**29.8**	13.1
Total comprehensive income for the year		**130.4**	141.5

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

Statements of changes in equity

for the year ended 31 December 2022

Bank (consolidated)	Share capital £ million	Share premium £ million	Merger reserve £ million	Fair value reserve £ million	Cash flow hedging reserve £ million	Retained profit £ million	Shareholder's equity £ million
Balance at 1 January 2021	79.4	195.6	412.8	11.6	(20.2)	1,045.7	1,724.9
Comprehensive profit:							
Profit for the year	–	–	–	–	–	128.4	128.4
Other comprehensive (loss)/income	–	–	–	(0.5)	13.6	–	13.1
Total comprehensive (loss)/income	–	–	–	(0.5)	13.6	128.4	141.5
Balance at 31 December 2021	79.4	195.6	412.8	11.1	(6.6)	1,174.1	1,866.4
Comprehensive profit:							
Profit for the year	**–**	**–**	**–**	**–**	**–**	**100.6**	**100.6**
Other comprehensive (loss)/income	**–**	**–**	**–**	**(17.2)**	**47.0**	**–**	**29.8**
Total comprehensive (loss)/income	**–**	**–**	**–**	**(17.2)**	**47.0**	**100.6**	**130.4**
Transactions with owner:							
Dividend paid	**–**	**–**	**–**	**–**	**–**	**(67.0)**	**(67.0)**
Total transactions with owner	**–**	**–**	**–**	**–**	**–**	**(67.0)**	**(67.0)**
Balance at 31 December 2022	**79.4**	**195.6**	**412.8**	**(6.1)**	**40.4**	**1,207.7**	**1,929.8**

Company	Share capital £ million	Share premium £ million	Merger reserve £ million	Fair value reserve £ million	Cash flow hedging reserve £ million	Retained profit £ million	Shareholder's equity £ million
Balance at 1 January 2021	79.4	195.6	412.8	11.6	(20.2)	1,045.7	1,724.9
Comprehensive income:							
Profit for the year	–	–	–	–	–	128.4	128.4
Other comprehensive (loss)/income	–	–	–	(0.5)	13.6	–	13.1
Total comprehensive (loss)/income	–	–	–	(0.5)	13.6	128.4	141.5
Balance at 31 December 2021	79.4	195.6	412.8	11.1	(6.6)	1,174.1	1,866.4
Comprehensive income:							
Profit for the year	**–**	**–**	**–**	**–**	**–**	**95.5**	**95.5**
Other comprehensive (loss)/income	**–**	**–**	**–**	**(17.2)**	**47.0**	**–**	**29.8**
Total comprehensive (loss)/income	**–**	**–**	**–**	**(17.2)**	**47.0**	**95.5**	**125.3**
Transactions with owner:							
Dividend paid	**–**	**–**	**–**	**–**	**–**	**(67.0)**	**(67.0)**
Total transactions with owner	**–**	**–**	**–**	**–**	**–**	**(67.0)**	**(67.0)**
Balance at 31 December 2022	**79.4**	**195.6**	**412.8**	**(6.1)**	**40.4**	**1,202.6**	**1,924.7**

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

Cash flow statements

for the year ended 31 December 2022

	Note	Bank (Consolidated) 2022 £ million	Bank (consolidated) 2021 £ million	Company 2022 £ million	Company 2021 £ million
Cash flows from operating activities					
Profit before taxation		**181.1**	155.5	**176.0**	155.5
Adjustments for:					
Change in operating assets and liabilities	31	**160.2**	(2,404.5)	**165.3**	(2,404.5)
Non-cash and other items	31	**186.4**	112.0	**186.4**	112.0
Taxation paid		**(34.4)**	(8.7)	**(34.4)**	(8.7)
Net cash provided by/(used in) operating activities		**493.3**	(2,145.7)	**493.3**	(2,145.7)
Cash flows from investing activities					
Purchase of property and equipment		**(36.8)**	(44.5)	**(36.8)**	(44.5)
Purchase and development of intangible assets		**(17.5)**	(30.3)	**(17.5)**	(30.3)
Purchase of debt securities		**(580.1)**	(1,324.5)	**(580.1)**	(1,324.5)
Sale of debt securities		**442.6**	500.9	**442.6**	500.9
Proceeds from maturing investments		**67.0**	23.0	**67.0**	23.0
Interest received on debt securities		**44.5**	36.3	**44.5**	36.3
Net cash used in investing activities		**(80.3)**	(839.1)	**(80.3)**	(839.1)
Cash flows from financing activities					
Additional borrowings from central banks		**510.0**	5,500.0	**510.0**	5,500.0
Repayment of borrowing from central banks		**(510.0)**	(3,065.0)	**(510.0)**	(3,065.0)
Interest paid on borrowings from central banks		**(57.3)**	(7.8)	**(57.3)**	(7.8)
Issue of covered bonds		**–**	500.0	**–**	500.0
Repayment of covered bonds		**(500.0)**	–	**(500.0)**	–
Interest paid on covered bonds		**(29.5)**	(21.0)	**(29.5)**	(21.0)
Issue of senior unsecured debt securities		**700.0**	–	**700.0**	–
Repayment of senior unsecured debt securities		**(450.0)**	–	**(450.0)**	–
Interest paid on senior unsecured debt securities		**(15.8)**	–	**(15.8)**	–
Issue of subordinated liabilities		**–**	300.0	**–**	300.0
Repayment of subordinated liabilities		**–**	(385.0)	**–**	(385.0)
Interest paid on subordinated liabilities		**(10.3)**	(18.8)	**(10.3)**	(18.8)
Issue of repurchase agreements		**359.9**	–	**359.9**	–
Interest paid on repurchase agreements		**(2.6)**	–	**(2.6)**	–
Lease payments		**(19.7)**	(22.8)	**(19.7)**	(22.8)
Net cash (used in)/provided by financing activities		**(25.3)**	2,779.6	**(25.3)**	2,779.6
Change in cash and cash equivalents		**387.7**	(205.2)	**387.7**	(205.2)
Cash and cash equivalents at 1 January	31	**4,851.1**	5,056.3	**4,851.1**	5,056.3
Cash and cash equivalents at 31 December	31	**5,238.8**	4,851.1	**5,238.8**	4,851.1

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

Notes to the financial statements

Sources of funding

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

Accounting policies relevant to sources of funding

(a) Financial liabilities

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

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

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

1. Customer deposits

Bank and Company	2022 £ million	2021 £ million
Bank accounts	**14,070.6**	14,371.1
Instant access saving deposits	**16,387.8**	17,042.1
Deposits with agreed maturity	**3,153.7**	1,757.9
Business banking deposits	**2,726.1**	2,780.8
Total customer deposits	**36,338.2**	35,951.9

2. Wholesale funding

(i) Debt securities in issue

Bank and Company 2022	Balance at 1 Jan 2022 £ million	Issues/ (Repayments) £ million	Accounting adjustments[1] £ million	Balance at 31 Dec 2022 £ million
Covered bond programme:				
Series 2017-1 covered bonds	**499.0**	**(500.0)**	**1.0**	**–**
Series 2019-1 covered bonds	**750.1**	**–**	**3.5**	**753.6**
Series 2021-1 covered bonds	**500.0**	**–**	**(0.5)**	**499.5**
	1,749.1	**(500.0)**	**4.0**	**1,253.1**
Senior unsecured debt securities	**450.0**	**250.0**	**2.4**	**702.4**
Total debt securities in issue	**2,199.1**	**(250.0)**	**6.4**	**1,955.5**

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

(1) Accounting adjustments comprise of accrued interest and unamortised issuance discount.

Notes to the financial statements

Sources of funding (continued)

2. Wholesale funding (continued)

Bank and Company	Date of issue	31 Dec 2022 £ million	31 Dec 2021 £ million	Interest rate at 31 Dec 2022	Maturity date	Issue currency
Issuing entity						
TSB Bank plc – Series 2017-1 covered bonds	12/2017	**–**	499.0	–	12/2022	GBP
TSB Bank plc – Series 2019-1 covered bonds	02/2019	**753.6**	750.1	3.91%	02/2024	GBP
TSB Bank plc – Series 2021-1 covered bonds	06/2021	**499.5**	500.0	3.80%	06/2028	GBP
TSB Bank plc – senior unsecured debt securities	12/2020	**–**	450.0	–	06/2023	GBP
TSB Bank plc – senior unsecured debt securities	06/2022	**451.3**	–	5.88%	06/2027	GBP
TSB Bank plc – senior unsecured debt securities	12/2022	**251.1**	–	6.83%	12/2026	GBP
Total debt securities in issue		**1,955.5**	2,199.1			

Covered bond programmes

Loans and advances to customers of £3,319.3 million (2021: £2,563.5 million) have been assigned to a limited liability partnership to provide security for the issuance of covered bonds, which at 31 December 2022 totalled £1,253.1 million (2021: £1,749.1 million). The Company retains the risks and rewards associated with these loans and the loans continue to be recognised on the Company's balance sheet. The related covered bonds in issue are included within debt securities in issue.

Cash deposits of £77.8 million (2021: £56.1 million) held by TSB are restricted in use to repayment of the term advances related to covered bonds and other legal obligations (note 7 on page 41). At 31 December 2022, the Company had over-collateralised the covered bond programmes in order to meet the programme terms, secure the external credit rating of the covered bonds, and to provide operational flexibility. The obligations of the Company to provide collateral may increase due to the formal requirements of the programmes. The Company may also voluntarily contribute collateral to support the ratings of the covered bonds but did not do so during 2022 or 2021. During 2022 and 2021, there were no defaults on any principal or interest or any other breaches with respect to borrowings under the covered bond programmes.

Senior unsecured debt securities in issue

In June 2022, the Company issued £450.0 million floating rate notes, due to mature in June 2027, to its parent company, TSB Banking Group plc, to satisfy MREL requirements. These were issued at a price of 100% of the principal amount. The notes pay interest at SONIA plus 2.45%, payable quarterly in arrears. The Company has the option to redeem these notes in June 2026 and quarterly thereafter, subject to approval of the PRA. These notes replaced the £450.0 million floating rate notes issued by the Company to its parent in December 2020 and which paid interest at SONIA plus 2.1%. The Company exercised its option to redeem these notes in June 2022.

In December 2022, the Company issued £250.0 million floating rate notes, due to mature in December 2026, to its parent company, Sabadell, to satisfy MREL requirements. These were issued at a price of 100% of the principal amount. The notes pay interest at SONIA plus 3.4% payable quarterly in arrears. The Company has the option to redeem these notes in December 2025 and quarterly thereafter, subject to approval of the PRA.

Securitisation programmes

At 31 December 2022, loans and advances to customers include £1,274.2 million (2021: £nil) of mortgages securitised under TSB's securitisation programmes, which have been sold to bankruptcy remote structured entities. As the structured entities are funded by the issue of debt on terms whereby the majority of the risks and rewards of the mortgages are retained by TSB, the structured entities are consolidated fully and all of these loans are retained on TSB's balance sheet. At 31 December 2022, all related notes in issue were retained by TSB and therefore no amounts were recognised in debt securities in issue.

Cash deposits of £81.4 million (2021: £nil) held by TSB structured entities are restricted in use to repayment of the debt securities issued by the structured entity and other legal obligations (note 7 on page 41).

Sources of funding (continued)

2. Wholesale funding (continued)

(ii) Borrowings from central banks
At 31 December 2022, borrowings from central banks represented borrowings under the Bank of England's (BOE) Term Funding Scheme with additional incentives for SMEs (TFSME) and borrowings under the BOE's indexed long-term repo operations (ILTRO). Borrowings from central banks are secured on certain pre-positioned mortgages at the BOE. The TFSME borrowings outstanding at 31 December 2022 are due to mature at various dates, with £4,412 million due to mature during 2025 and the remaining £588 million during 2027. The ILTRO borrowings outstanding at 31 December 2022 are due to mature during the first half of 2023.

	2022 £ million	2021 £ million
Term Funding Scheme with additional incentives for SMEs	**5,000.0**	5,500.0
Indexed long term repurchase agreements	**500.0**	–
Accrued interest	**38.3**	1.6
Total borrowings from central banks	**5,538.3**	5,501.6

(iii) Repurchase agreements
At 31 December 2022, TSB had entered into £360.0 million (2021: £nil) of repurchase agreements that transferred legal title of certain UK gilts in return for cash, together with an agreement to repurchase the assets at a later date and at a predetermined price.

The fair value of the transferred gilts was £360.3 million (2021: £nil), comprising £165.4 million of gilts recognised on TSB's balance sheet and £194.9 million received under reverse repurchase agreements. The on balance sheet gilts were not derecognised from the balance sheet, as substantially all of the rewards, including interest income, and risks, including credit and interest rate risks, are retained by TSB. In all cases, the transferee has the right to sell or repledge the gilts concerned, subject to delivering the securities at the repurchase date.

3. Subordinated liabilities

Bank and Company	2022 £ million	2021 £ million
Fixed-to-floating rate callable subordinated Tier 2 capital notes, due March 2031	**300.0**	300.0
Accrued interest	**0.1**	0.1
Fair value hedge accounting adjustment (note 21)	**(34.7)**	(8.3)
Total subordinated liabilities	**265.4**	291.8

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

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

4. Other financial liabilities

Bank and Company	2022 £ million	2021 £ million
Items in the course of transmission to credit institutions	**59.0**	44.0
Items in the course of transmission to non-credit institutions	**4.7**	4.6
Collateral placed by central clearing houses	**1,245.5**	143.6
Collateral placed by credit institutions	**10.1**	1.4
Deposits from credit institutions	**0.8**	–
Total other financial liabilities	**1,320.1**	193.6

Collateral placed by central clearing houses and by credit institutions represents cash collateral in respect of interest rate derivatives. The increase in the balance in 2022 reflects the effects of higher interest rates which has resulted in a corresponding increase in the carrying value of derivative financial instruments.

Notes to the financial statements

Sources of funding (continued)

5. Fair value of financial liabilities

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

Bank and Company	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2022					
Customer deposits	**–**	**36,322.9**	**–**	**36,322.9**	**36,338.2**
Debt securities in issue	**1,249.7**	**722.6**	**–**	**1,972.3**	**1,955.5**
Subordinated liabilities	**–**	**276.2**	**–**	**276.2**	**265.4**
Derivative liabilities at fair value through profit or loss	**–**	**1,252.4**	**–**	**1,252.4**	**1,252.4**
Hedging derivative liabilities	**–**	**301.5**	**–**	**301.5**	**301.5**
At 31 December 2021					
Customer deposits	–	35,952.4	–	35,952.4	35,951.9
Debt securities in issue	1,762.5	451.9	–	2,214.4	2,199.1
Subordinated liabilities	–	299.8	–	299.8	291.8
Derivative liabilities at fair value through profit or loss	–	156.5	–	156.5	156.5
Hedging derivative liabilities	–	136.8	–	136.8	136.8

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis. If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same for which market observable prices exist, net present value and discounted cash flow analysis.

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

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

Valuation hierarchy of financial instruments
Financial instruments carried at fair value, or for which fair values are disclosed, have been classified into three levels according to the quality and reliability of information used to determine the fair values. There were no transfers between levels in 2022 or 2021.

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

Notes to the financial statements

Loans and liquid assets

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

Accounting policies relevant to loans and liquid assets

(b) Classification and measurement of financial assets

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

Classification and measurement

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

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

Financial assets that are debt instruments measured at amortised cost

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

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

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

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

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

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

Accounting policies relevant to loans and liquid assets (continued)

(c) Impairment of financial assets

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

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

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

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

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

Significant increase in credit risk

Financial assets are considered to be in stage 2 when their credit risk has increased significantly since initial recognition.

- The main factor that is considered by the Bank is an increase in the residual lifetime Probability of Default (PD) since initial recognition. A loan will be considered to have experienced a significant increase in credit risk, and be transferred from stage 1 to stage 2 if the residual lifetime PD has increased by both a relative threshold (being a multiplier of the origination PD) and an absolute increase in the PD amount as compared to the PD at the origination of the financial asset. The relative and absolute thresholds for each portfolio are set out on page 47.
- As a secondary qualitative assessment criterion, financial assets that are in forbearance but not credit impaired are considered to have experienced significant increase in credit risk and will be in stage 2.
- As a backstop, the Bank does not rebut the presumption in IFRS 9 that all financial assets that are more than 30 days past due have experienced a significant increase in credit risk. Consequently, in respect of loans and advances to customers, TSB does not use the practical expedient in IFRS 9 which permits low credit risk loans (i.e. those considered investment grade) to remain in stage 1 without an assessment of significant increase ('low credit risk exemption'). However, in respect of all other categories of financial assets at amortised cost and financial assets at fair value through other comprehensive income, the Bank uses the low credit risk exemption and categorises these financial assets as stage 1.

Credit Impaired (stage 3)

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

Definition of default for IFRS 9

Loans and advances that are more than 90 days past due, or considered by management as unlikely to pay their obligations, are considered, for IFRS 9 purposes, to be in default, non performing, and credit impaired (stage 3). Examples of loans considered unlikely to pay include customers in bankruptcy or subject to an individual voluntary arrangement, customers undergoing repossession, and customers who have received a forbearance treatment, generally within the previous two years, and have subsequently either moved back in to early arrears or have received an additional forbearance measure. Customers who have cured but who were 90 days past due, or considered unlikely to pay, in the previous six months are also considered to remain in default and classified as credit impaired. TSB policy is not to rebut the presumption in IFRS 9 that loans which are more than 90 days past due are in default.

Notes to the financial statements

Loans and liquid assets (continued)

Accounting policies relevant to loans and liquid assets (continued)

(c) Impairment of financial assets (continued)

Purchased or originated credit impaired (POCI)

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

Write offs

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

Modified financial assets and derecognition

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

Methodology for measuring expected credit losses

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

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

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

(d) Derecognition of financial assets

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

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

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

Notes to the financial statements

Loans and liquid assets (continued)

6. Debt securities

Bank and Company

Fair value through other comprehensive income (FVOCI)	2022 £ million	2021 £ million
UK Gilts	**509.5**	1,069.0
Total debt securities at FVOCI	**509.5**	1,069.0

Amortised cost	2022 £ million	2021 £ million
UK Gilts	**1,352.2**	1,614.3
Supranational and development bank bonds	**289.3**	339.0
Covered bonds	**310.1**	213.4
Total debt securities at amortised cost	**1,951.6**	2,166.7

Debt securities of £509.5 million (2021: £1,069.0 million) are held as part of the liquid asset portfolio, where the business model is to hold the assets to collect the contractual cash flows and to generate cash flows from selling the assets. These assets are carried at FVOCI.

Debt securities of £1,951.6 million (2021: £2,166.7 million) are held as part of a second, separate liquid asset portfolio, where the business model is solely to hold the assets to collect the contractual cash flows. These assets are carried at amortised cost.

At 31 December 2022, UK gilts at FVOCI with a carrying value of £165.4 million (2021: £nil) were subject to repurchase agreements. In addition, £48.2 million (2021: £257.5 million) of debt securities at amortised cost had been pledged as collateral.

7. Loans and advances to central banks and credit institutions

Bank	2022 £ million	2021 £ million
Loans and advances to central banks	**144.3**	143.6
Loans and advances to credit institutions:		
Restricted cash deposits held in covered bond structured entities (note 2(i))	**77.8**	56.1
Restricted cash deposits held in securitisation structured entities (note 2(i))	**81.4**	–
Total	**303.5**	199.7

Company	2022 £ million	2021 £ million
Loans and advances to central banks	**144.3**	143.6
Total	**144.3**	143.6

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

Notes to the financial statements

Loans and liquid assets (continued)

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

	2022 £ million	2021 £ million
Secured (retail)	**35,655.0**	34,833.8
Unsecured portfolios	**1,958.4**	1,990.6
Business banking	**571.9**	667.2
	38,185.3	37,491.6
Allowance for credit impairment losses (note 18)	**(198.0)**	(189.6)
Net customer lending balances	**37,987.3**	37,302.0
Valuation adjustments(1)	**62.7**	81.8
Loans and advances to customers	**38,050.0**	37,383.8

(1) Comprises accrued interest of £18.8 million (2021: £17.4 million) and effective interest rate adjustments of £43.9 million (2021: £64.4 million).

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

	2022 £ million	2021 £ million
Credit cards	**3,099.1**	3,038.7
Mortgage offers made	**1,420.8**	2,316.6
Current accounts and other lending	**1,097.5**	1,112.1
Total commitments	**5,617.4**	6,467.4

The credit impairment provision in respect of total loan commitments is shown in note 29 on page 81.

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

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

Forward looking economic scenarios
TSB currently uses four economic scenarios (2021: five scenarios), representative of management's view of forecast economic conditions. During 2022, the number of scenarios was decreased from five to four, as the low-rate severe downside scenario, whilst remaining under review, was considered to be less relevant in the current economic environment. Key scenario assumptions are set internally for GDP, house prices, unemployment and interest rates. The forecast for these metrics is compared with data published by the Bank of England and other external sources to ensure the scenarios are suitably benchmarked.

The severe downside is aligned with the high-rate ICAAP scenario, and is used to capture non-linearity in expected credit losses. This is where the relationship of credit losses to the relevant economic variables which influence credit losses (e.g. house prices or unemployment) is such that each unit of change in an economic variable does not lead to a uniform change in expected credit losses. For example, credit losses in secured portfolios may remain subdued in an environment where house prices exhibit only a small decrease. However, after a certain level of house price decline, credit losses would be forecast to increase more meaningfully as collateral values fall by a similar proportion below the level of customer loans.

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

The four scenarios, together with the weightings applied at December 2022, are described below.

Notes to the financial statements

Loans and liquid assets (continued)

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

Forward looking economic scenarios (continued)

2022 economic scenarios

Base case scenario (60% weighting)
The base case assumes that the UK is already in recession, which continues in 2023. This downturn leads to higher unemployment (peaking at 5.25%) and a fall in house prices (down 10% in 2023). The Bank of England (BOE) base rate (Bank Rate) peaks at 4.5%.

The base case scenario is more pessimistic than the base scenario used in 2021 reflecting, in particular, the global effects of the war in Ukraine, the economic consequences of the COVID-19 pandemic, and recent periods of instability in financial markets. Materially higher interest rates relative to the previous base case scenario contribute to a larger decline in house prices (peak to trough fall of 10% as compared to 4% in the 2021 base case scenario). Unemployment is forecast to peak in the 2022 base case scenario at 5.25%, marginally below the 5.5% forecast in the 2021 base case. However, the 2022 base case scenario forecasts a slower reduction thereafter, with unemployment forecast to remain elevated at 4.9% by the end of 2025, as compared to an improvement to 3.5% in the 2021 base case scenario.

Upside (10% weighting)
The upside scenario assumes that the current recession is brief, with stagnation rather than contraction in 2023. Inflation is expected to fade more quickly while Bank Rate peaks at 3.5%. Unemployment remains broadly flat at 3.75% and house prices recover more quickly.

Downside scenario (20% weighting)
In the downside scenario, the risk of a deep global recession is more acute than the threat of persistent inflation. Unemployment rises to a peak of 6.4% and house prices decline by 18%. Interest rates rise to a slightly lower peak than in the base case, and the BOE subsequently cuts the Bank Rate faster and further.

Severe downside (high interest rate) scenario (10% weighting)
The severe downside scenario assumes that high and persistent inflation prompts an aggressive policy response by the BOE. Bank Rate rises to 7%, which leads to a deep recession, with GDP falling by 5.0% over the course of 2023. Unemployment rises to 8.5% and house prices fall by 32%.

2021 economic scenarios

Base case scenario: Cautious recovery following the COVID-19 economic 'shock' in 2020 (50% weighting)
The recovery in GDP that commenced in 2021 continues with a return to pre-pandemic levels in early 2022. Interest rates rise but remain low by historic standards. Inflation returns to its 2% target following an overshoot in 2022 and 2023. Unemployment is assumed to be at the high point of the forecast period at the end of 2021, following the end of the furlough scheme, but is assumed to fall back to 4.1% by the end of 2023. House prices decline in early 2022, following the end of the stamp duty holiday but resume a gentle upward trajectory thereafter.

Upside: A benign reflation (10% weighting)
Pandemic related headwinds ease more quickly than in the base case and the economy is boosted by supportive fiscal and monetary policies. Unemployment falls more quickly than the base case due to a stronger recovery and faster productivity improvements. The BOE increases the base rate from early 2022, though rates remain low by historic standards.

Downside scenario: Renewed pandemic headwinds (30% weighting)
Another wave of the pandemic weighs heavily on the recovery in 2022. Unemployment rises relative to the base case, peaking at 7.0% in the middle of 2022. This triggers a moderate correction in house prices which experience a peak to trough fall of 18%. Against this backdrop, the BOE holds off on rate hikes until 2026.

Severe downside (low interest rate) scenario: Uncontrolled pandemic (5% weighting)
A vaccine-resistant variant emerges, which leads to severe instability in financial markets and another sharp downturn for the UK economy. GDP falls by 9.0% in the first quarter of 2022, and the unemployment rate rises quickly to a peak of 11.9% by the end of 2022. House prices fall sharply, with a peak to trough fall of 34%. In response, the BOE takes its base rate into negative territory, to (0.1)%, for the first time. However, the downturn is short-lived and followed by an extremely strong GDP rebound.

Severe downside (high interest rate) scenario: Prolonged stagflation (5% weighting)
Inflation surges in 2022, due to a variety of factors, including prolonged supply bottlenecks and labour shortages. Inflation expectations increase forcing the BOE to tighten policy significantly (with its base rate peaking at 3.25%). The economy enters another downturn without having fully recovered from the 2020 crisis. As a result, GDP fails to recover to pre-COVID-19 levels during the forecast period to 2026. Unemployment rises sharply, to a peak of 11.2% by the middle of 2023. Higher interest rates and rising unemployment lead to a 36% peak to trough decline in house prices.

Notes to the financial statements

Loans and liquid assets (continued)

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

Forward looking economic scenarios (continued)

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

At 31 December 2022[1]		Base case	Upside	Downside	Severe downside (High rate)	Severe downside (Low rate)
Scenario weighting		**60%**	**10%**	**20%**	**10%**	**n/a**
GDP	Peak to trough fall	**(1.3)%**	**n/a**	**(3.7)%**	**(5.0)%**	**n/a**
Unemployment	Peak rate	**5.25%**	**3.75%**	**6.4%**	**8.5%**	**n/a**
House prices	Peak-to-trough fall	**(10)%**	**(5)%**	**(18)%**	**(32)%**	**n/a**
Interest rates	Most extreme rate	**4.5%**	**3.5%**	**4.25%**	**7.0%**	**n/a**
At 31 December 2021						
Scenario weighting		50%	10%	30%	5%	5%
GDP	Peak to trough fall	n/a	n/a	(4.0)%	(4.7)%	(9.0)%
Unemployment	Peak rate	5.5%	5.5%	7.0%	11.2%	11.9%
House prices	Peak-to-trough fall	(4)%	(2)%	(18)%	(36)%	(34)%
Interest rates	Most extreme rate	1.0%	1.5%	0.1%	3.25%	(0.1)%

(1) GDP decline is relative to Q4 2022. Unemployment peak is from Q1 2023 onwards. House price decline is relative to December 2022. The most extreme interest rate is the interest rate furthest from the current rate, either positive or negative during the forecast period.

Scenario weightings have evolved from those applied in 2021. Specifically, in the light of a more pessimistic base case scenario, as described above, the combined weighting applied to downside scenarios (downside and severe downside scenarios) has been reduced to 30% (2021: 40%). Within this, the probability applied to severe downside scenarios has however been retained at 10%, with this being applied solely in 2022 to the high rate severe downside scenario following the removal of the low interest rate downside scenario.

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

Scenario	Weighting	Economic measure[1]	2023	2024	2025	2026	2027
							At 31 December 2022
Upside	**10%**	GDP	**(0.4)%**	**0.8 %**	**1.3 %**	**1.3%**	**1.4%**
		Unemployment	**3.8 %**	**3.8 %**	**3.8 %**	**3.8%**	**3.8%**
		House prices	**(4.3)%**	**(0.4)%**	**1.3 %**	**3.9%**	**3.5%**
		Interest rates	**3.5 %**	**3.25 %**	**3.25 %**	**3.0%**	**2.75%**
Base	**60%**	GDP	**(1.3)%**	**(0.2)%**	**1.0 %**	**1.3%**	**1.4%**
		Unemployment	**4.8 %**	**5.3 %**	**4.9 %**	**4.5%**	**4.1%**
		House prices	**(8.9)%**	**(0.9)%**	**1.1 %**	**2.4%**	**2.5%**
		Interest rates	**4.5 %**	**4.25 %**	**3.75 %**	**3.5%**	**3.25%**
Downside	**20%**	GDP	**(2.5)%**	**(1.4)%**	**1.0 %**	**1.3%**	**1.4%**
		Unemployment	**6.2 %**	**6.2 %**	**5.4 %**	**4.8%**	**4.3%**
		House prices	**(9.1)%**	**(9.6)%**	**3.9 %**	**4.3%**	**4.3%**
		Interest rates	**4.25 %**	**3.5 %**	**3.25 %**	**3.0%**	**2.75%**
Severe downside (High rate)	**10%**	GDP	**(3.2)%**	**(1.6)%**	**1.2 %**	**1.2%**	**1.2%**
		Unemployment	**7.6 %**	**8.3 %**	**7.7 %**	**7.1%**	**6.5%**
		House prices	**(10.4)%**	**(15.2)%**	**(8.3)%**	**7.2%**	**6.6%**
		Interest rates	**7.0 %**	**6.5 %**	**5.5 %**	**4.75%**	**4.0%**
Weighted average	**n/a**	GDP	**(1.6)%**	**(0.5)%**	**1.1 %**	**1.3%**	**1.4%**
		Unemployment	**5.2 %**	**5.6 %**	**5.1 %**	**4.7%**	**4.3%**
		House prices	**(8.6)%**	**(4.0)%**	**0.9 %**	**3.3%**	**3.3%**
		Interest rates	**4.6 %**	**4.2 %**	**3.8 %**	**3.5%**	**3.2%**

Notes to the financial statements

Loans and liquid assets (continued)

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

Forward looking economic scenarios (continued)

							At 31 December 2021
Scenario	**Weighting**	**Economic measure**[1]	2022	2023	2024	2025	2026
Upside	10%	GDP	6.3 %	2.8 %	1.6 %	1.6 %	1.6 %
		Unemployment	3.5 %	3.5 %	3.5 %	3.5 %	3.5 %
		House prices	3.2 %	4.3 %	2.6 %	2.5 %	2.5 %
		Interest rates	0.75 %	1.25 %	1.5 %	1.5 %	1.5 %
Base	50%	GDP	4.8 %	1.5 %	1.4 %	1.4 %	1.4 %
		Unemployment	4.8 %	4.1 %	4.0 %	4.0 %	4.0 %
		House prices	(2.8)%	2.4 %	2.5 %	2.5 %	2.5 %
		Interest rates	0.5 %	0.75 %	0.75 %	0.75 %	1.0 %
Downside	35%	GDP	1.3 %	2.4 %	1.2 %	1.2 %	1.2 %
		Unemployment	6.7 %	5.6 %	4.7 %	4.5 %	4.5 %
		House prices	(14.3)%	0.8 %	10.9 %	5.0 %	4.2 %
		Interest rates	0.1 %	0.1 %	0.1 %	0.1 %	0.25 %
Severe downside (Low rate)	5%	GDP	(0.4)%	10.0 %	4.3 %	2.1 %	1.5 %
		Unemployment	11.9 %	10.0 %	6.6 %	5.0 %	4.8 %
		House prices	(25.9)%	(1.3)%	22.3 %	7.9 %	6.0 %
		Interest rates	(0.1)%	(0.1)%	(0.1)%	0 %	0.1 %
Severe downside (High rate)	5%	GDP	(1.4)%	0 %	1.3 %	1.4 %	1.4 %
		Unemployment	10.3 %	11.2 %	10.2 %	9.1 %	8.1 %
		House prices	(25.9)%	(12.6)%	8.6 %	10.0 %	10.0 %
		Interest rates	3.25 %	3.25 %	3.0 %	2.5 %	2.0 %
Weighted average	n/a	GDP	3.3 %	2.3 %	1.5 %	1.4 %	1.4 %
		Unemployment	5.9 %	5.1 %	4.6 %	4.4 %	4.3 %
		House prices	(8.0)%	1.2 %	6.3 %	3.9 %	3.6 %
		Interest rates	0.5 %	0.7 %	0.7 %	0.7 %	0.8 %

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

Key variables in each of the scenarios are assumed to revert to a long term constant rate over a period of up to two years after the end of the forecast period. The reversionary rates used are as follows: GDP 1.5% (2021: 1.5%), unemployment 4.0% (2021: 4.0%); interest rates 1.5% (2021: 1.0%); and house price growth of 3.75% (2021: 3.75%) per annum.

Sensitivity to alternative economic scenario weightings

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

	2022 £ million	**2021 £ million**
Allowance for credit losses	**198.0**	189.6
Provision for off balance sheet exposures (note 29)	**13.9**	16.7
Combined on and off balance sheet - using weighted forecast	**211.9**	206.3
Increase/(decrease) if a 100% weighting was applied to each scenario:		
Upside	**(56.7)**	(39.8)
Base case	**(29.8)**	(28.3)
Downside	**12.0**	5.1
Severe downside – low interest rate	**n/a**	252.6
Severe downside – high interest rate	**181.1**	278.5
Proportion of gross loan balance in stage 2:		
Reported – using weighted forecast	**10.1%**	6.9%
Upside	**6.6%**	6.4%
Base case	**9.1%**	6.7%
Downside	**9.8%**	7.3%
Severe downside – low interest rate	**n/a**	10.1%
Severe downside – high interest rate	**22.2%**	24.5%

Notes to the financial statements

Loans and liquid assets (continued)

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

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

Judgements required in assessing post model adjustments
The allowance for credit impairment losses included PMAs as shown below:

	Secured (retail) £ million	Unsecured £ million	Business Banking £ million	2022 £ million	Secured (retail) £ million	Unsecured £ million	Business Banking £ million	2021 £ million
ECL before post model adjustments	**4.6**	**139.2**	**4.9**	**148.7**	7.9	115.8	4.1	127.8
Post model adjustments:								
Impairment default triggers	**30.4**	**16.2**	**3.5**	**50.1**	10.5	(1.5)	0.3	9.3
Model performance	**18.3**	**(22.7)**	**(2.4)**	**(6.8)**	3.1	9.5	–	12.6
Operational matters	**0.9**	**2.6**	**1.2**	**4.7**	0.7	1.2	1.6	3.5
Bounce Back Loan Scheme	**–**	**–**	**1.3**	**1.3**	–	–	2.6	2.6
COVID-19 related (consumer behaviour)	**–**	**–**	**–**	**–**	16.3	15.5	2.0	33.8
Total post model adjustments	**49.6**	**(3.9)**	**3.6**	**49.3**	30.6	24.7	6.5	61.8
Total allowance for credit impairment losses	**54.2**	**135.3**	**8.5**	**198.0**	38.5	140.5	10.6	189.6

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

Impairment default triggers

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

- During 2022, additional PMAs have been required to address the cost of living challenges faced by customers, where affordability strain is not fully captured in the existing ECL models. The impact on customers' ability to afford their mortgage payments in the light of rising inflation is captured through an affordability assessment that uses external credit bureau data and customer data. Customers with negative affordability are considered to have experienced a significant increase in credit risk and subsequently leads to an increase in credit losses. The PMAs for the unsecured portfolio are determined by an affordability assessment using internal current account data, supplemented with external data where appropriate. The increase in PMAs associated with affordability and cost of living during 2022 was £32 million, with additional provision raised across all portfolios.

Model performance

- PMAs are required to mitigate risks associated with model performance. An example of this is the requirement to capture the impact of economic projections falling outside of the range of historical observations on which models were developed (secured) or where models are overpredicting recent performance (unsecured) ahead of model recalibration being undertaken.

Operational matters

- PMAs are used to address the risk of certain operational matters. This includes a low volume of customer accounts which require bespoke assessments of their underlying credit risk, for example, relating to mortgages on high value properties for which models have not been calibrated.

Bounce Back Loan Scheme

- A small PMA is retained to capture the risk associated with Bounce Back Loans where the government's guarantee might not be fully enforceable.

Loans and liquid assets (continued)

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

Judgements required in assessing post model adjustments (continued)

COVID-19 related (consumer behaviour)

- During 2022, COVID-19 related PMAs were released as the impacts of the pandemic on bank support packages, wider government support, and customer behaviour, had receded and adjustment of the IFRS9 model was no longer required. In 2021, the PMA captured the increased risk of credit losses arising from changes in consumer behaviour which may not have been appropriately captured when conditioning the impairment models. For example, circumstances, such as customer repayment holidays, static bureau data reporting, and associated exclusion from forbearance classifications, together with changes in customer spending patterns all resulted in atypical outcomes, when comparisons are made to equivalent metrics prior to the pandemic. This typically involved portfolio adjustments to risk grade or staging to capture the underlying risk.

Judgements required in assessing significant increase in credit risk
TSB's policy for determining when a financial asset has experienced a significant increase in credit risk is explained on page 73. In applying this policy, the key judgement is the level of increase in the residual lifetime PD as compared to the equivalent position at the origination of the financial asset.

At 31 December 2022 loans and advances to customers were considered to have experienced a significant increase in credit risk (and classified in stage 2) if the residual lifetime PD had increased by both the relative threshold (being a multiplier of the origination PD) and the absolute increase in PD, both as compared to the PD at time of the loan's origination:

	2022 Relative Increase in PD	2022 Absolute Increase in PD	2021 Relative Increase in PD	2021 Absolute Increase in PD
Secured (retail):				
Mortgages	**2 times**	**410bps**	2 times	410bps
Whistletree	**2 times**	**10bps**	2 times	10bps
Unsecured:				
Credit cards	**2 times**	**250bps**	2 times	250bps
Personal loans	**2 times**	**770bps**	2 times	770bps
Overdrafts	**1 times**	**400bps**	2 times	250bps
Business banking	**2 times**	**50bps**	2 times	50bps

In assessing the appropriateness of this judgement, management applied a framework that considered a number of quantitative factors, including the accuracy of the thresholds and their predictive ability. As a result of this assessment, a change was applied to the overdraft criteria in 2022, leading to an improvement in both accuracy and predictiveness of the thresholds. This change resulted in the transfer during the year of £11.4 million of gross balances from stage 1 to stage 2, and an associated increase in impairment allowance of £2.1 million.

Further to this, PMAs were applied to the modelled staging outcomes to align with the PMAs applied in measuring the impairment allowance. This resulted in the net transfer of £650.0 million gross Secured (retail) balances from stage 1 to stage 2, largely to capture the effects of the affordability PMA (recorded under impairment default triggers). Partially offsetting this, was a transfer of £42.5 million from stage 2 to stage 1 in Business banking to address known model performance matters.

Notes to the financial statements

Loans and liquid assets (continued)

9. Other advances

Bank and Company	2022 £ million	2021 £ million
Items in the course of collection from credit institutions	**21.7**	17.7
Items in the course of collection from non-credit institutions	**4.5**	12.9
Collateral placed at central clearing houses	**525.1**	21.5
Collateral placed with credit institutions	**130.6**	0.1
Amounts due from the British Business Bank	**21.3**	28.5
Total other advances	**703.2**	80.7

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

10. Fair value of financial assets

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

Bank	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2022					
Debt securities at amortised cost	**1,935.1**	**–**	**–**	**1,935.1**	**1,951.6**
Loans and advances to customers	**–**	**–**	**36,294.1**	**36,294.1**	**38,050.0**
Financial assets at fair value through other comprehensive income	**509.5**	**–**	**–**	**509.5**	**509.5**
Derivative assets at fair value through profit or loss	**–**	**1,158.7**	**–**	**1,158.7**	**1,158.7**
Hedging derivative assets	**–**	**1,565.9**	**–**	**1,565.9**	**1,565.9**
At 31 December 2021					
Debt securities at amortised cost	2,164.1	30.0	–	2,194.1	2,166.7
Loans and advances to customers	–	–	37,644.1	37,644.1	37,383.8
Financial assets at fair value through other comprehensive income	1,069.0	–	–	1,069.0	1,069.0
Derivative assets at fair value through profit or loss	–	168.4	–	168.4	168.4
Hedging derivative assets	–	244.5	–	244.5	244.5

Company	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2022					
Debt securities at amortised cost	**1,935.1**	**–**	**–**	**1,935.1**	**1,951.6**
Loans and advances to customers	**–**	**–**	**36,294.1**	**36,294.1**	**38,050.0**
Financial assets at fair value through other comprehensive income	**509.5**	**–**	**–**	**509.5**	**509.5**
Derivative assets at fair value through profit or loss	**–**	**1,073.2**	**–**	**1,073.2**	**1,073.2**
Hedging derivative assets	**–**	**1,565.9**	**–**	**1,565.9**	**1,565.9**
At 31 December 2021					
Debt securities at amortised cost	2,164.1	30.0	–	2,194.1	2,166.7
Loans and advances to customers	–	–	37,644.1	37,644.1	37,383.8
Financial assets at fair value through other comprehensive income	1,069.0	–	–	1,069.0	1,069.0
Derivative assets at fair value through profit or loss	–	168.4	–	168.4	168.4
Hedging derivative assets	–	244.5	–	244.5	244.5

Notes to the financial statements

Loans and liquid assets (continued)

10. Fair value of financial assets (continued)

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

The Bank provides loans at both fixed and variable rates. Fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Bank and other financial institutions. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. During 2022, the significant increase in market interest rates had the effect of reducing the fair value of loans and advances to customers relative to their carrying amount.

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

Notes to the financial statements

Income

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

Accounting policies relevant to recognising income

(e) Interest income and expense

Financial instruments classified as amortised cost and fair value through other comprehensive income

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

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

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

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

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

Derivative financial instruments

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

(f) Other operating income

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

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

Notes to the financial statements

Income (continued)

11. Net interest income

Bank	2022 £ million	2021 £ million
Interest and similar income		
Interest income calculated using the effective interest method:		
Cash, cash balances at central banks and other demand deposits	**64.7**	3.9
Financial assets at fair value through other comprehensive income	**6.8**	9.5
Debt securities at amortised cost	**30.7**	16.7
Loans to credit institutions	**2.8**	–
Loans and advances to customers	**1,018.0**	916.3
	1,123.0	946.4
Derivative financial instruments	**108.7**	(35.0)
Total interest and similar income	**1,231.7**	911.4
Interest and similar expense		
Interest expense calculated using the effective interest method:		
Borrowings from central banks	**(94.1)**	(8.6)
Customer deposits	**(67.4)**	(29.2)
Debt securities in issue	**(51.7)**	(20.9)
Subordinated liabilities	**(10.3)**	(15.6)
Lease liabilities	**(1.3)**	(2.6)
Other financial liabilities	**(15.2)**	(0.1)
Provisions	**–**	(0.9)
	(240.0)	(77.9)
Derivative financial instruments	**(10.0)**	35.4
Total interest and similar expense	**(250.0)**	(42.5)
Net interest income	**981.7**	868.9

Included within interest and similar income is £14.0 million (2021: £16.2 million) in respect of impaired financial assets.

12. Net fee and commission income

Bank	2022 £ million	2021 £ million
Fee and commission income		
Bank accounts	**51.7**	53.4
Credit and debit card fee income	**60.4**	44.4
Insurance commission income	**8.6**	9.1
Other	**14.8**	14.9
	135.5	121.8
Fee and commission expense	**(21.3)**	(18.2)
Net fee and commission income	**114.2**	103.6

13. Other operating income

Bank	2022 £ million	2021 £ million
Migration related income	**5.9**	10.3
Rental income	**0.6**	0.5
Other income	**0.1**	0.1
Total other operating income	**6.6**	10.9

Migration related income comprises insurance recoveries of post migration losses of £3.0 million (2021: £10.3 million), which remain subject to ongoing management, and a further migration related VAT recovery of £2.9 million (2021: £nil) following the finalisation of the matter.

Notes to the financial statements

Charges

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

Accounting policies relevant to recognising charges

(g) Pensions and other post-retirement benefits

The Bank operates defined contribution pension plans under which fixed contributions are paid. The costs of the Bank's defined contribution plans are charged to the income statement, as an operating expense, in the period in which they fall due.

(h) Share-based compensation

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

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

(i) Taxation

Current corporation tax which is payable or receivable on taxable profits or losses is recognised as a tax expense or credit in the period in which the profits or losses arise.

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

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

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

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

Notes to the financial statements

Charges (continued)

14. Operating expenses

Bank	2022 £ million	2021 £ million
Staff costs		
Wages and salaries	**231.5**	238.6
Social security costs	**26.8**	26.3
Other pension costs	**30.4**	31.6
Severance costs	**4.9**	8.6
Other staff costs	**10.4**	7.2
Total staff costs	**304.0**	312.3
Premises expenses		
Rent	**2.3**	1.7
Rates, maintenance and other premises expenses	**30.4**	43.0
Total premises expenses	**32.7**	44.7
Other expenses		
IT servicing and licence costs	**206.5**	222.6
Regulatory, legal and consultancy costs	**109.1**	42.5
Marketing	**26.4**	36.1
Other expenses(1)	**124.8**	98.9
Total other expenses	**466.8**	400.1
Depreciation of property and equipment	**34.7**	37.4
Depreciation of right of use asset	**17.3**	25.1
Amortisation of intangible assets	**14.0**	7.7
Total operating expenses	**869.5**	827.3

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

Regulatory, legal and consultancy costs include migration related items of £51.1 million (2021: £0.6 million), comprising of regulatory fines of £48.7 million (2021: £nil) and additional post migration costs of £2.4 million (2021: £0.6 million).

Included in the above table are notable conduct charges of £28.6 million (2021: £2.2 million) which are analysed by cost category in the table below.

Notable conduct charges	2022 £ million	2021 £ million
Regulatory, legal and consultancy costs	**1.5**	2.2
Other expenses	**27.1**	–
Notable conduct charges	**28.6**	2.2

Included in the above table are restructuring costs of £11.5 million (2021: £26.5 million) which are analysed by cost category in the table below. These primarily relate to costs of a multi-year branch restructuring and head office reorganisation programme that, since it commenced in 2019, has included the closure of 316 branches.

Restructuring costs	2022 £ million	2021 £ million
Staff costs	**5.9**	9.0
Premises expenses	**(0.2)**	(3.0)
Other expenses	**1.0**	3.3
Depreciation	**4.8**	17.2
Restructuring costs	**11.5**	26.5

The monthly average number of employees on a headcount basis during the year was 5,592 (2021: 6,137), all of whom were employed in the UK. Remuneration paid to key management personnel (note 24(i)) is included in staff costs.

Notes to the financial statements

Charges (continued)

14. Operating expenses (continued)

Share based compensation
Staff costs include £3.3 million (2021: £1.8 million) in respect of share based compensation arrangements. Such arrangements are limited to the operation of a Share Incentive Plan (SIP) which provide employees with the opportunity to own shares in Sabadell and the granting, where relevant, of shares to certain senior employees as part of their recruitment arrangements.

As all share based compensation arrangements involve an award of Sabadell shares, where TSB retains the obligation to settle, these arrangements are accounted for as cash settled share based payment arrangements resulting in the recognition of a liability. This liability is remeasured monthly, with changes recognised in operating expenses, to reflect the latest Sabadell share price and the estimated number of shares expected to vest. At 31 December 2022, £8.3 million (2021: £5.3 million) was recognised in respect of share based payment liabilities.

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

	2022 £ million	2021 £ million
Fees payable to the Company's auditor for the audit of the Company's annual accounts (1)	**3.6**	3.0
Fees payable to the Company's auditor and its associates for other services:		
Audit of the accounts of subsidiaries	**0.1**	–
Audit related assurance services (2)	**1.3**	1.5
Other non audit services	**–**	0.1
Total fees payable to TSB's auditors	**5.0**	4.6

(1) Additional fees of £0.2 million were incurred in 2022 relating to the 2021 audit (2021: £0.3 million incurred in 2021 respect of the 2020 audit) and are not captured in the above table
(2) Primarily fees payable to the Company's auditor for the audit of the half year financial statements, as required by the Bank's ultimate parent company, Sabadell.

15. Directors' emoluments

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

	2022 £ 000	2021 £ 000
Remuneration paid to Directors in respect of qualifying services	**3,714**	3,241
Employer contributions to pension schemes (including cash paid in lieu)	**174**	284
Cash paid under long-term incentive arrangements	**319**	60
Total	**4,207**	3,585

The aggregate remuneration of the highest paid director was £1,815,139 (2021: £1,075,903) for qualifying services as a TSB director.

The table below presents the number of Directors who:

	2022 Number	2021 Number
Exercised share options in the parent company, Sabadell	**–**	–
Received Sabadell shares under long term incentive schemes	**–**	–
Accrued pension benefits under defined contribution pension schemes	**–**	2

Notes to the financial statements

Charges (continued)

16. Taxation

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

Bank	2022 £ million	2021 £ million
UK corporation tax		
Current tax		
Current tax charge on profit for the year	**(33.4)**	(9.9)
Adjustment in respect of prior year	**(0.8)**	–
Current tax charge	**(34.2)**	(9.9)
Deferred tax (note 17)		
Origination and reversal of temporary differences:		
Deferred tax charge on business transfers	**–**	(20.5)
Change in UK corporation tax rate	**(12.3)**	15.3
Accelerated capital allowances	**0.6**	1.2
Adjustments in respect of prior years	**4.4**	2.7
Utilisation of carried forward trading losses	**(36.7)**	(13.3)
Other	**(2.3)**	(2.6)
Deferred tax charge	**(46.3)**	(17.2)
Taxation charge	**(80.5)**	(27.1)

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

Bank	2022 £ million	2021 £ million
Profit before taxation	**181.1**	155.5
Taxation charge at applied UK corporation tax rate of 27.0% (2021: 27.0%)	**(48.9)**	(42.0)
Factors affecting charge:		
Disallowed costs	**(26.4)**	(5.1)
Non-taxable items	**1.4**	–
Changes to UK corporation tax rates	**(12.3)**	15.3
Adjustments in respect of prior years	**3.6**	2.7
Taxable profits not subject to 8% bank surcharge	**2.0**	2.0
Other	**0.1**	–
Taxation charge	**(80.5)**	(27.1)

The applied UK corporation tax rate of 27% includes the 8% bank surcharge on profits in excess of £25 million together with the main UK corporation tax rate of 19%. Disallowed costs in 2022 primarily reflected the £48.7 million fines imposed by the FCA and PRA in respect of the handling of the 2018 migration of data and IT systems and in respect of conduct charges of £33.6 million (see note 29 on page 81). Disallowed costs in 2021 primarily reflected restructuring costs.

Changes to UK corporation tax rates
In February 2022, the bank surcharge rate decrease from 8% to 3%, effective from April 2023, was substantively enacted. The effect of this was to decrease the value of deferred tax assets by £12.3 million, with a corresponding deferred tax charge recognised in the 2022 statement of comprehensive income.

In May 2021 the UK corporation tax rate increase from 19% to 25%, effective from April 2023, was substantively enacted. The effect of this was to increase the value of deferred tax assets by £15.3 million, with a corresponding deferred tax credit recognised in the 2021 statement of comprehensive income.

Notes to the financial statements

Charges (continued)

17. Deferred tax assets

The movement in deferred tax assets is as follows:

	Bank 2022 £ million	Bank 2021 £ million	Company 2022 £ million	Company 2021 £ million
At 1 January	**122.6**	144.5	**122.6**	144.5
Income statement charge (note 16)	**(46.3)**	(17.2)	**(46.3)**	(17.2)
Amounts charged to shareholder's equity:				
Movements in fair value reserve	**6.4**	0.3	**6.4**	0.3
Movements in cash flow hedge reserve	**(18.2)**	(5.0)	**(18.2)**	(5.0)
At 31 December	**64.5**	122.6	**64.5**	122.6

Deferred tax assets are comprised as follows:

	Bank 2022 £ million	Bank 2021 £ million	Company 2022 £ million	Company 2021 £ million
Deferred tax arising on carried forward trading losses	**54.9**	98.9	**54.9**	98.9
Deferred tax in respect of the transition to IFRS 9	**13.4**	18.3	**13.4**	18.3
Deferred tax arising on cash flow hedge reserve	**(15.8)**	2.4	**(15.8)**	2.4
Revaluations of financial assets at fair value through other comprehensive income	**2.3**	(4.1)	**2.3**	(4.1)
Other temporary differences	**9.7**	7.1	**9.7**	7.1
Total deferred tax assets	**64.5**	122.6	**64.5**	122.6

Notes to the financial statements

Managing financial risk

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

Accounting policies relevant to managing financial risk

(j) Derivative financial instruments and hedge accounting

All derivative financial instruments are recognised at their fair value. Fair values are determined using valuation techniques, including discounted cash flow as appropriate. Derivatives are carried on the balance sheet as assets when their fair value is positive and as liabilities when their fair value is negative.

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

Hedge accounting

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

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

Fair value hedges

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

Cash flow hedges

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk

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

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

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

TSB reviews, at least annually, its provision forecast against actual loss experience to identify whether its policies have resulted in over or under provisioning across the economic cycle. Stress and scenario testing are widely used throughout TSB to assess the potential impact on impaired exposures and related provisions. A robust governance framework has been established to monitor impairment exposures, provisions and the impact of alternative economic scenarios and stress scenarios. Findings and recommendations are reported to regular Portfolio Quality Review meetings, Executive Risk Committees, Audit Committee and the Board.

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

Financial assets at amortised cost:	2022 Exposure £ million	2022 Credit Quality	2021 Exposure £ million	2021 Credit Quality
Cash, cash balances at central banks and other demand deposits:	**5,238.8**		4,851.1	
Cash	***87.9***	***Not rated***	*100.7*	*Not rated*
Balances with central banks	***5,141.2***	***AA-***	*4,741.5*	*AA-*
On demand deposits	***9.7***	***At least BBB***	*8.9*	*At least BBB*
Debt securities(1)	**1,951.6**	**At least AA-**	2,166.7	At least AA-
Loans and advances to customers	**38,050.0**	**Note 18(ii)**	37,383.8	Note 18(ii)
Loans and advances to central banks and credit institutions	**303.5**		199.7	
Loans and advances to credit institutions	***159.2***	***A+***	*56.1*	*A+*
Loans and advances to central banks	***144.3***	***AA-***	*143.6*	*AA-*
Other advances	**703.2**		80.7	
Government institutions	***21.3***	***AA-***	*28.6*	*AA-*
Other advances	***681.9***	***Not rated***	*52.1*	*Not rated*
Financial assets at fair value through other comprehensive income	**509.5**	**AA-**	1,069.0	AA-
Financial assets subject to expected credit loss requirements	**46,756.6**		45,751.0	
Derivative financial assets(2)	**2,724.6**		412.9	
Total on-balance sheet financial assets	**49,481.2**		46,163.9	
Lending commitments	**5,617.4**	**Note 18(ii)**	6,467.4	Note 18(ii)
Maximum credit risk exposure	**55,098.6**		52,631.3	

(1) Includes £546.2 million (2021: £472.8 million) rated AAA.
(2) The net uncollateralised derivative balance was £409.4 million (2021: £0.4 million) for the Bank and £435.0 million (2021: £0.4 million) for the Company, with counterparties rated A+, as set out in note 21,

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

(ii) Staging analysis

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

At 31 December 2022	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	POCI[1] £ million	Total £ million
Loans and advances to customers					
Secured (retail)	**31,812.9**	**3,366.8**	**366.8**	**108.5**	**35,655.0**
Unsecured	**1,486.9**	**398.3**	**72.4**	**0.8**	**1,958.4**
Business banking	**437.3**	**101.7**	**32.9**	**–**	**571.9**
Gross customer lending balances	**33,737.1**	**3,866.8**	**472.1**	**109.3**	**38,185.3**
ECL on drawn balances	**(38.1)**	**(96.0)**	**(63.3)**	**(0.6)**	**(198.0)**
Net customer lending balance	**33,699.0**	**3,770.8**	**408.8**	**108.7**	**37,987.3**
Valuation adjustments[2]					**62.7**
Net balance sheet carrying value					**38,050.0**
Allowance for credit impairment losses					
Secured (retail)	**14.0**	**26.2**	**13.3**	**0.6**	**54.1**
Unsecured[3]	**17.9**	**68.3**	**49.2**	**–**	**135.4**
Business banking	**6.2**	**1.5**	**0.8**	**–**	**8.5**
Total	**38.1**	**96.0**	**63.3**	**0.6**	**198.0**
Coverage (%)					
Secured (retail)	**0.04%**	**0.78%**	**3.63%**	**0.55%**	**0.15%**
Unsecured	**1.20%**	**17.15%**	**67.96%**	**–**	**6.91%**
Business banking	**1.42%**	**1.47%**	**2.43%**	**–**	**1.49%**
Total	**0.11%**	**2.48%**	**13.41%**	**0.55%**	**0.52%**

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

(1) Purchased or originated as credit impaired.
(2) Comprises accrued interest of £18.8 million (2021: £17.4 million) and effective interest rate adjustments of £43.9 million (2021: £64.4 million).
(3) Excludes expected credit impairment provisions for off balance sheet exposures of £13.9 million (2021: £16.7 million). These comprise of stage 1 £4.4 million (2021: £8.9 million), stage 2 £7.2 million (2021: £4.8 million), stage 3 £2.2 million (2021: £3.0 million), and £0.1m POCI (2021: £nil).

For all other classes of financial assets (as listed in note 18(i) on page 58), expected credit losses have been assessed as immaterial.

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

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

	Stage 1		Stage 2		Stage 3		POCI		Total	
TSB	**Gross £ million**	**ECL £ million**	**Gross £ million**	**ECL £ million**	**Gross £ million**	**ECL £ million**	**Gross £ million**	**ECL £ million**	**Gross £ million**	**ECL £ million**
At 1 January 2022	34,280.5	(59.0)	2,583.9	(74.4)	502.4	(55.4)	124.8	(0.8)	37,491.6	(189.6)
Changes reflected in impairment losses:	1,266.4	9.1	(331.6)	(40.1)	(161.7)	(19.3)	(15.5)	0.2	756.6	(50.1)
Increases due to originations	8,671.7	(20.4)	183.3	(1.1)	32.4	(0.1)	8.2	–	8,895.6	(21.6)
Decreases due to repayments	(7,405.3)	3.4	(514.9)	4.9	(195.1)	4.8	(23.7)	(0.2)	(8,139.0)	12.9
Changes in credit risk[1]	–	26.1	–	(43.9)	–	(24.0)	–	0.4	–	(41.4)
Amounts written off	(0.3)	–	(0.7)	–	(61.9)	41.7	–	–	(62.9)	41.7
Transfers between stages[2] [3]	(1,809.5)	11.8	1,615.2	18.5	194.3	(30.3)	–	–	–	–
To stage 1	3,412.5	(16.9)	(3,367.6)	16.7	(44.9)	0.2	–	–	–	–
To stage 2	(5,149.5)	27.7	5,219.9	(30.9)	(70.4)	3.2	–	–	–	–
To stage 3	(72.5)	1.0	(237.1)	32.7	309.6	(33.7)	–	–	–	–
At 31 December 2022	33,737.1	(38.1)	3,866.8	(96.0)	472.1	(63.3)	109.3	(0.6)	38,185.3	(198.0)
Secured (retail)										
At 1 January 2022	32,182.5	(10.4)	2,121.1	(18.9)	406.8	(8.4)	123.4	(0.8)	34,833.8	(38.5)
Changes reflected in impairment losses:	1,144.3	(4.5)	(210.9)	(6.1)	(97.3)	(5.2)	(14.9)	0.2	821.2	(15.6)
Increases due to originations	7,045.6	(7.3)	7.1	–	9.0	–	4.3	–	7,066.0	(7.3)
Decreases due to repayments	(5,901.3)	0.5	(218.0)	0.3	(106.3)	2.2	(19.2)	(0.2)	(6,244.8)	2.8
Changes in credit risk	–	2.3	–	(6.4)	–	(7.4)	–	0.4	–	(11.1)
Amounts written off	–	–	–	–	–	–	–	–	–	–
Transfers between stages	(1,513.9)	0.9	1,456.6	(1.2)	57.3	0.3	–	–	–	–
To stage 1	2,518.7	(3.0)	(2,479.1)	3.0	(39.6)	–	–	–	–	–
To stage 2	(3,984.7)	3.7	4,046.1	(5.3)	(61.4)	1.6	–	–	–	–
To stage 3	(47.9)	0.2	(110.4)	1.1	158.3	(1.3)	–	–	–	–
At 31 December 2022	31,812.9	(14.0)	3,366.8	(26.2)	366.8	(13.3)	108.5	(0.6)	35,655.0	(54.1)
Unsecured										
At 1 January 2022	1,622.8	(42.5)	300.9	(51.9)	65.5	(46.1)	1.4	–	1,990.6	(140.5)
Changes reflected in impairment losses:	166.7	14.3	(125.0)	(36.0)	(11.9)	(13.9)	(0.6)	–	29.2	(35.6)
Increases due to originations	1,591.6	(11.9)	162.9	(0.8)	22.0	(0.1)	3.9	–	1,780.4	(12.8)
Decreases due to repayments	(1,424.9)	2.5	(287.9)	4.0	(33.9)	2.3	(4.5)	–	(1,751.2)	8.8
Changes in credit risk	–	23.7	–	(39.2)	–	(16.1)	–	–	–	(31.6)
Amounts written off	(0.3)	–	(0.6)	–	(60.5)	40.7	–	–	(61.4)	40.7
Transfers between stages:	(302.3)	10.3	223.0	19.6	79.3	(29.9)	–	–	–	–
To stage 1	647.4	(11.7)	(644.3)	11.5	(3.1)	0.2	–	–	–	–
To stage 2	(926.8)	21.2	933.9	(22.8)	(7.1)	1.6	–	–	–	–
To stage 3	(22.9)	0.8	(66.6)	30.9	89.5	(31.7)	–	–	–	–
At 31 December 2022	1,486.9	(17.9)	398.3	(68.3)	72.4	(49.2)	0.8	–	1,958.4	(135.4)
Business banking										
At 1 January 2022	475.2	(6.1)	161.9	(3.6)	30.1	(0.9)	–	–	667.2	(10.6)
Changes reflected in impairment losses:	(44.6)	(0.7)	4.3	2.0	(53.5)	(0.2)	–	–	(93.8)	1.1
Increases due to originations	34.5	(1.2)	13.3	(0.3)	1.4	–	–	–	49.2	(1.5)
Decreases due to repayments	(79.1)	0.4	(9.0)	0.6	(54.9)	0.3	–	–	(143.0)	1.3
Changes in credit risk	–	0.1	–	1.7	–	(0.5)	–	–	–	1.3
Amounts written off	–	–	(0.1)	–	(1.4)	1.0	–	–	(1.5)	1.0
Transfers between stages:	6.7	0.6	(64.4)	0.1	57.7	(0.7)	–	–	–	–
To stage 1	246.4	(2.2)	(244.2)	2.2	(2.2)	–	–	–	–	–
To stage 2	(238.0)	2.8	239.9	(2.8)	(1.9)	–	–	–	–	–
To stage 3	(1.7)	–	(60.1)	0.7	61.8	(0.7)	–	–	–	–
At 31 December 2022	437.3	(6.2)	101.7	(1.5)	32.9	(0.8)	–	–	571.9	(8.5)

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

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

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

Performance overview
Gross loans balances increased by £693.6 million to £38,185.3 million, driven by secured retail lending growth. This was partly offset by the expected reduction in the closed Whistletree portfolio. The slower pace of growth in 2022 reflected management action to manage volumes in a highly volatile and competitive mortgage market.

Stage 1 gross customer lending balances decreased by £543.4 million to £33,737.1 million, largely reflecting a net transfer to stage 2 of £1,782.4 million, which more than offset originations, net of repayments of £1,266.4 million. Included in net transfers to stage 2 are PMAs of £650.0 million, largely to capture the effects of the cost of living overlay (see note 8 on page 47).

Stage 2 gross customer lending balances increased by £1,282.9 million to £3,866.8 million. This reflected the more challenging economic outlook as reflected in higher forecast unemployment and interest rates (as described more fully in note 8 on page 43) and included the cost of living PMA referred to above. The increase in stage 2 balances was partially offset by ongoing loan repayments by customers.

Stage 3 gross customer lending balances decreased by £30.3 million to £472.1 million, primarily driven by a reduction in secured (retail) from ongoing customer repayments.

Gross loans written off during 2022 of £62.9 million (2021: £56.1 million) continue to be subject to the right to undertake enforcement activities, despite there being no realistic prospect of recovery.

Reconciliation to amounts recognised in the income statement

	2022 £ million	2021 £ million
Income statement charge reported in allowance for credit impairment losses:		
Increases due to originations(1)	**21.6**	48.2
Decreases due to repayments(1)	**(12.9)**	(21.5)
Charge/(credit) due to changes in credit risk(1)	**41.4**	(35.9)
Release to income statement of allowance associated with gross carrying amounts written off(1)	**(41.7)**	(40.2)
Other amounts charged to impairment losses in the income statement:		
Gross carrying amounts written off to income statement	**62.9**	56.1
Recoveries of amounts previously written off	**(14.4)**	(14.1)
Other amounts charged to the income statement	**0.8**	10.0
Impairment losses on financial assets at amortised cost	**57.7**	2.6
Impairment losses on financial assets at amortised cost	**57.7**	2.6
Impairment credit on credit impairment provisions in respect of loan commitments	**(2.8)**	(2.5)
Impairment losses per income statement	**54.9**	0.1

(1) As reported in the reconciliation of movements in allowances for credit impairment losses in note 18(iii) on page 60 and 61.

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

(iv) Stage 2 balances

There can be a number of reasons that require a financial asset to be subject to a stage 2 lifetime ECL calculation other than reaching the 30 days past due backstop. The following table shows the reason for stage 2 classification at the reporting date.

At 31 December 2022	PD Deterioration £ million	Performing Forborne £ million	>30DPD £ million	Total £ million
Gross customer lending balances				
Secured (retail)	**3,212.7**	**50.7**	**103.4**	**3,366.8**
Unsecured	**377.2**	**3.8**	**17.3**	**398.3**
Business banking	**78.1**	**0.5**	**23.1**	**101.7**
Total	**3,668.0**	**55.0**	**143.8**	**3,866.8**
Allowance for credit impairment losses				
Secured (retail)	**24.0**	**0.2**	**2.0**	**26.2**
Unsecured	**60.1**	**0.5**	**7.7**	**68.3**
Business banking	**1.4**	**–**	**0.1**	**1.5**
Total	**85.5**	**0.7**	**9.8**	**96.0**

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

(v) Stage 3 balances

	2022		2021	
Stage 3	Gross loans £ million	ECL £ million	Gross loans £ million	ECL £ million
Credit impaired - not in a cure period	**220.5**	**(35.9)**	263.9	(31.5)
Credit impaired - in the cure period that precedes transfer to stage 2	**251.6**	**(27.4)**	238.5	(23.9)
Total stage 3	**472.1**	**(63.3)**	502.4	(55.4)

Balances that are credit impaired and not in a cure period comprise of loans and advances to customers that are more than 90 days past due, or considered by management as unlikely to pay their obligations, as described under the heading 'definition of default for IFRS 9' on page 39. Balances that were credit impaired but operating within the cure period required by TSB policy prior to a transfer to stage 2 comprise of customers who have cured but who were 90 days past due, or considered unlikely to pay, in the previous six months.

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

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

	PD range Lower	PD range Upper	Internal Grading
Excellent quality	0%	1.200%	0-3
Good quality	1.201%	4.500%	4-5
Satisfactory quality	4.501%	14.000%	6-8
Lower quality	14.001%	20.000%	9
Below standard (including in default)	20.001%	100%	10-13

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

	Gross loans					Allowance for credit impairment losses				
2022	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	POCI £ million	Total £ million	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	POCI £ million	Total £ million
Secured (retail)										
Excellent quality	**31,312.6**	**4.2**	**–**	**1.8**	**31,318.6**	**13.3**	**–**	**–**	**–**	**13.3**
Good quality	**406.6**	**148.1**	**–**	**55.8**	**610.5**	**0.5**	**1.4**	**–**	**–**	**1.9**
Satisfactory quality	**83.2**	**2,073.4**	**–**	**15.1**	**2,171.7**	**0.2**	**5.6**	**–**	**–**	**5.8**
Lower quality	**5.7**	**199.4**	**–**	**0.6**	**205.7**	**–**	**1.2**	**–**	**–**	**1.2**
Below standard	**4.8**	**941.7**	**366.8**	**35.2**	**1,348.5**	**–**	**18.0**	**13.3**	**0.6**	**31.9**
	31,812.9	**3,366.8**	**366.8**	**108.5**	**35,655.0**	**14.0**	**26.2**	**13.3**	**0.6**	**54.1**
Unsecured										
Excellent quality	**756.9**	**35.1**	**3.4**	**–**	**795.4**	**4.5**	**3.0**	**2.4**	**–**	**9.9**
Good quality	**614.9**	**196.0**	**7.3**	**–**	**818.2**	**8.8**	**22.8**	**4.8**	**–**	**36.4**
Satisfactory quality	**103.4**	**110.0**	**7.8**	**0.5**	**221.7**	**3.5**	**21.5**	**4.7**	**–**	**29.7**
Lower quality	**7.2**	**18.2**	**2.5**	**–**	**27.9**	**0.5**	**4.9**	**1.4**	**–**	**6.8**
Below standard	**4.5**	**39.0**	**51.4**	**0.3**	**95.2**	**0.6**	**16.1**	**35.9**	**–**	**52.6**
	1,486.9	**398.3**	**72.4**	**0.8**	**1,958.4**	**17.9**	**68.3**	**49.2**	**–**	**135.4**
Business banking										
Excellent quality	**171.4**	**–**	**–**	**–**	**171.4**	**1.6**	**–**	**–**	**–**	**1.6**
Good quality	**255.5**	**1.2**	**–**	**–**	**256.7**	**4.4**	**–**	**–**	**–**	**4.4**
Satisfactory quality	**10.4**	**29.7**	**–**	**–**	**40.1**	**0.2**	**0.6**	**–**	**–**	**0.8**
Lower quality	**–**	**25.8**	**–**	**–**	**25.8**	**–**	**0.5**	**–**	**–**	**0.5**
Below standard	**–**	**45.0**	**32.9**	**–**	**77.9**	**–**	**0.4**	**0.8**	**–**	**1.2**
	437.3	**101.7**	**32.9**	**–**	**571.9**	**6.2**	**1.5**	**0.8**	**–**	**8.5**
Total										
Excellent quality	**32,240.9**	**39.3**	**3.4**	**1.8**	**32,285.4**	**19.4**	**3.0**	**2.4**	**–**	**24.8**
Good quality	**1,277.0**	**345.3**	**7.3**	**55.8**	**1,685.4**	**13.7**	**24.2**	**4.8**	**–**	**42.7**
Satisfactory quality	**197.0**	**2,213.1**	**7.8**	**15.6**	**2,433.5**	**3.9**	**27.7**	**4.7**	**–**	**36.3**
Lower quality	**12.9**	**243.4**	**2.5**	**0.6**	**259.4**	**0.5**	**6.6**	**1.4**	**–**	**8.5**
Below standard	**9.3**	**1,025.7**	**451.1**	**35.5**	**1,521.6**	**0.6**	**34.5**	**50.0**	**0.6**	**85.7**
	33,737.1	**3,866.8**	**472.1**	**109.3**	**38,185.3**	**38.1**	**96.0**	**63.3**	**0.6**	**198.0**
Off balance sheet commitments										
Excellent quality	**4,567.3**	**103.2**	**7.2**	**0.2**	**4,677.9**	**3.4**	**1.1**	**1.2**	**–**	**5.7**
Good quality	**403.6**	**332.5**	**3.9**	**13.3**	**753.3**	**0.7**	**3.4**	**0.4**	**–**	**4.5**
Satisfactory quality	**89.6**	**49.1**	**2.4**	**0.1**	**141.2**	**0.3**	**1.7**	**0.3**	**–**	**2.3**
Lower quality	**2.6**	**6.5**	**0.5**	**7.6**	**17.2**	**–**	**0.3**	**–**	**0.1**	**0.4**
Below standard	**1.4**	**12.8**	**13.6**	**–**	**27.8**	**–**	**0.7**	**0.3**	**–**	**1.0**
Total	**5,064.5**	**504.1**	**27.6**	**21.2**	**5,617.4**	**4.4**	**7.2**	**2.2**	**0.1**	**13.9**

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

	Gross loans					Allowance for credit impairment losses				
2021	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	POCI £ million	Total £ million	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	POCI £ million	Total £ million
Secured (retail)										
Excellent quality	31,570.1	12.2	–	2.0	31,584.3	9.2	14.5	–	–	23.7
Good quality	589.5	153.5	–	46.0	789.0	1.1	0.4	–	–	1.5
Satisfactory quality	18.2	1,286.9	–	26.1	1,331.2	0.1	2.0	–	–	2.1
Lower quality	2.1	172.8	–	0.5	175.4	–	0.2	–	–	0.2
Below standard	2.6	495.7	406.8	48.8	953.9	–	1.8	8.4	0.8	11.0
	32,182.5	2,121.1	406.8	123.4	34,833.8	10.4	18.9	8.4	0.8	38.5
Unsecured										
Excellent quality	672.9	12.2	2.6	–	687.7	9.7	1.0	1.6	–	12.3
Good quality	833.8	139.9	7.5	–	981.2	23.3	15.0	4.6	–	42.9
Satisfactory quality	106.5	109.1	8.0	0.3	223.9	8.0	20.2	5.0	–	33.2
Lower quality	4.4	18.2	3.8	–	26.4	0.8	5.8	2.5	–	9.1
Below standard	5.2	21.5	43.6	1.1	71.4	0.7	9.9	32.4	–	43.0
	1,622.8	300.9	65.5	1.4	1,990.6	42.5	51.9	46.1	–	140.5
Business banking										
Excellent quality	200.0	–	–	–	200.0	1.7	–	–	–	1.7
Good quality	250.2	0.8	–	–	251.0	3.9	–	–	–	3.9
Satisfactory quality	24.9	77.1	–	–	102.0	0.5	1.8	–	–	2.3
Lower quality	–	4.0	–	–	4.0	–	0.1	–	–	0.1
Below standard	0.1	80.0	30.1	–	110.2	–	1.7	0.9	–	2.6
	475.2	161.9	30.1	–	667.2	6.1	3.6	0.9	–	10.6
Total										
Excellent quality	32,443.0	24.4	2.6	2.0	32,472.0	20.6	15.5	1.6	–	37.7
Good quality	1,673.5	294.2	7.5	46.0	2,021.2	28.2	15.4	4.6	–	48.2
Satisfactory quality	149.6	1,473.1	8.0	26.4	1,657.1	8.6	24.0	5.0	–	37.6
Lower quality	6.5	195.0	3.8	0.5	205.8	0.8	6.1	2.5	–	9.4
Below standard	7.9	597.2	480.5	49.9	1,135.5	0.8	13.4	41.7	0.8	56.7
	34,280.5	2,583.9	502.4	124.8	37,491.6	59.0	74.4	55.4	0.8	189.6
Off balance sheet loan commitments										
Excellent quality	5,648.5	39.8	8.3	0.2	5,696.8	5.9	1.0	1.1	–	8.0
Good quality	413.3	211.6	3.8	12.0	640.7	1.5	2.1	0.6	–	4.2
Satisfactory quality	59.8	29.1	2.3	0.3	91.5	1.5	1.1	0.4	–	3.0
Lower quality	0.7	9.1	0.8	8.0	18.6	–	0.4	0.1	–	0.5
Below standard	0.8	3.3	15.5	0.4	20.0	–	0.2	0.8	–	1.0
Total	6,123.1	292.9	30.7	20.9	6,467.6	8.9	4.8	3.0	–	16.7

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

(vii) Collateral held as security for financial assets

Financial assets subject to expected credit loss requirements

TSB holds collateral against loans and advances to customers in the form of retail mortgages over residential property. TSB also holds collateral against commercial secured products in the form of business assets, including commercial and residential property.

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

					2022					2021
LTV of Secured (retail)	**Stage 1 £ million**	**Stage 2 £ million**	**Stage 3 £ million**	**POCI £ million**	**Total £ million**	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	POCI £ million	Total £ million
Less than 70%	**25,087.0**	**3,169.4**	**331.5**	**101.8**	**28,689.7**	22,876.0	1,909.7	347.5	106.2	25,239.4
70% to 80%	**4,404.1**	**151.7**	**25.9**	**5.0**	**4,586.7**	6,561.5	164.0	36.7	11.8	6,774.0
80% to 90%	**2,087.0**	**34.8**	**5.2**	**0.5**	**2,127.5**	2,535.4	43.8	13.2	4.1	2,596.5
90% to 100%	**227.9**	**3.9**	**2.1**	**0.3**	**234.2**	199.9	2.8	3.6	0.3	206.6
Greater than 100%	**6.9**	**7.0**	**2.1**	**0.9**	**16.9**	9.7	0.8	5.8	1.0	17.3
Secured (retail)	**31,812.9**	**3,366.8**	**366.8**	**108.5**	**35,655.0**	32,182.5	2,121.1	406.8	123.4	34,833.8

Climate risk, both physical and transitional, is considered when assessing property collateral valuations at origination. TSB concludes that this risk is currently low and no material losses have been experienced from such risks.

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

For business banking lending, collateral primarily consists of first charges over commercial and residential property. Where collateral is held, lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on any collateral provided. Collateral values are assessed at the time of loan origination and reassessed if there is observable evidence of distress of the borrower. In respect of the £378.8 million (2021: £518.8 million) of Bounce Back Loan Scheme loans, TSB benefits from a 100% guarantee from the British Business Bank under the terms of the scheme rules (amounts recoverable under this guarantee are shown in note 9 on page 48).

Financial assets at fair value through profit or loss (not subject to expected credit loss requirements)

Bank

Derivative financial assets of £2,724.6 million (2021: £412.9 million) are largely cash collateralised interest rate swaps transacted through central clearing houses.

Company

Derivative financial assets of £2,639.1 million (2021: £412.9 million) are largely cash collateralised interest rate swaps transacted through central clearing houses.

The effect of the collateralisation is shown in note 21 on page 74 under the heading Offsetting financial assets and financial liabilities.

(viii) Forbearance and loan modifications

TSB operates a number of schemes to assist borrowers who are experiencing financial difficulties. Forbearance solutions may offer relief in the form of reductions to contractual payments including freezes to interest payments, and for customers who have longer term financial difficulties, term extensions and capitalisation of arrears. TSB applies the European Banking Authority definition of forbearance and at 31 December 2022, forborne loans were £352.1 million (2021: £318.8 million), of which £238.1 million (2021: £222.6 million) were credit impaired. At 31 December 2022, the allowance for loan losses held in respect of forborne loans was £49.7 million (2021: £42.0 million).

During 2022 gross balances of £41.5 million (2021: £35.3 million) in respect of unsecured loans were subject to modification of the original terms through the temporary freezing of customer interest obligations. At the time, the loans were categorised as either stage 2 or 3 and the allowance for expected credit losses was measured at lifetime expected credit loss. These resulted in modification losses of £2.0 million (2021: £1.7 million).

Notes to the financial statements

Managing financial risk (continued)

19. Liquidity risk

Definition and exposure

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

Sources of funding

The Bank's funding position is underpinned by its significant customer deposit base. The deposit base is made up of customer current and savings accounts which, although mostly repayable on demand, have historically provided a stable source of funding.

Risk appetite

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

Measurement and monitoring

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

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

Bank and Company At 31 December 2022	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total Carrying Value £ million
Financial liabilities measured at amortised cost:						
Customer deposits	33,229.2	149.3	1,555.9	1,403.8	–	36,338.2
Repurchase agreements	360.0	–	–	–	–	360.0
Borrowings from central banks	35.6	–	502.7	5,000.0	–	5,538.3
Debt securities in issue	–	6.6	–	1,449.0	499.9	1,955.5
Subordinated liabilities	–	0.1	–	265.3	–	265.4
Lease liabilities	–	–	0.1	24.6	121.2	145.9
Other financial liabilities	1,320.1	–	–	–	–	1,320.1
Derivative liabilities at fair value through profit or loss	–	4.5	58.5	867.2	322.2	1,252.4
Hedging derivative liabilities	1.3	0.5	8.9	285.5	5.3	301.5
Total financial liabilities	**34,946.2**	**161.0**	**2,126.1**	**9,295.4**	**948.6**	**47,477.3**
Financial assets at amortised cost:						
Cash, cash balances at central banks & demand deposits	5,238.8	–	–	–	–	5,238.8
Debt securities	8.4	41.8	2.2	432.3	1,466.9	1,951.6
Loans and advances to customers	861.5	331.8	1,426.6	6,389.3	29,040.8	38,050.0
Loans and advances to credit institutions(1)	147.2	–	–	12.0	–	159.2
Loans and advances to central banks	144.3	–	–	–	–	144.3
Other advances	681.9	21.3	–	–	–	703.2
Financial assets at fair value through other comprehensive income	0.7	0.8	0.5	–	507.5	509.5
Derivative assets at fair value through profit or loss(2)	1.3	2.4	82.1	805.0	267.9	1,158.7
Hedging derivative assets	16.0	23.7	69.0	442.3	1,014.9	1,565.9
Total financial assets(1)(2)	**7,100.1**	**421.8**	**1,580.4**	**8,080.9**	**32,298.0**	**49,481.2**

(1) Loans and advances to credit institutions of £159.2 million are not included in the Company totals.

(2) Derivative assets at fair value through profit or loss include £85.5 million in 1-5 years that are not included in the Company totals.

Notes to the financial statements

Managing financial risk (continued)

19. Liquidity risk (continued)

Bank and Company At 31 December 2021	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
Financial liabilities measured at amortised cost:						
Customer deposits	34,247.7	150.6	791.3	762.3	–	35,951.9
Borrowings from central banks	1.6	–	–	5,500.0	–	5,501.6
Debt securities in issue	–	1.1	499.3	1,199.0	499.7	2,199.1
Subordinated liabilities	–	0.1	–	291.7	–	291.8
Lease liabilities	0.3	–	0.2	31.3	131.7	163.5
Other financial liabilities	193.6	–	–	–	–	193.6
Derivative liabilities at fair value through profit or loss	0.6	4.2	8.7	119.5	23.5	156.5
Hedging derivative liabilities	0.4	1.1	8.5	51.4	75.4	136.8
Total financial liabilities	34,444.2	157.1	1,308.0	7,955.2	730.3	44,594.8
Financial assets at amortised cost:						
Cash, cash balances at central banks & demand deposits	4,851.1	–	–	–	–	4,851.1
Debt securities	3.1	4.4	69.1	302.1	1,788.0	2,166.7
Loans and advances to customers	881.7	343.8	1,508.1	7,046.3	27,603.9	37,383.8
Loans and advances to credit institutions[(1)]	56.1	–	–	–	–	56.1
Loans and advances to central banks	143.6	–	–	–	–	143.6
Other advances	63.5	17.2	–	–	–	80.7
Financial assets at fair value through other comprehensive income	0.3	2.1	0.9	1.2	1,064.5	1,069.0
Derivative assets at fair value through profit or loss	1.4	1.7	17.1	129.5	18.7	168.4
Hedging derivative assets	–	–	18.0	98.6	127.9	244.5
Total financial assets	6,000.8	369.2	1,613.2	7,577.7	30,603.0	46,163.9

(1) Loans and advances to credit institutions of £56.1 million are not included in the Company totals.

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

Notes to the financial statements

Managing financial risk (continued)

19. Liquidity risk (continued)

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

Bank and Company At 31 December 2022	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
Financial liabilities measured at amortised cost:						
Customer deposits	**33,250.1**	**171.7**	**1,585.0**	**1,468.0**	**–**	**36,474.8**
Borrowings from central banks	**35.6**	**–**	**669.6**	**5,464.6**	**–**	**6,169.8**
Repurchase agreements	**360.0**	**–**	**–**	**–**	**–**	**360.0**
Debt securities in issue	**–**	**23.2**	**74.6**	**1,646.2**	**509.5**	**2,253.5**
Subordinated liabilities	**–**	**2.6**	**7.8**	**323.2**	**–**	**333.6**
Lease liabilities	**0.4**	**4.9**	**15.6**	**61.1**	**72.6**	**154.6**
Other financial liabilities	**1,320.1**	**–**	**–**	**–**	**–**	**1,320.1**
Loan commitments	**3,993.4**	**149.0**	**1,190.2**	**56.0**	**228.8**	**5,617.4**
	38,959.6	**351.4**	**3,542.8**	**9,019.1**	**810.9**	**52,683.8**
Derivative financial instruments - outflows	**44.4**	**84.9**	**591.6**	**1,897.2**	**228.7**	**2,846.8**
Derivative financial instruments - inflows	**(24.2)**	**(37.1)**	**(263.6)**	**(737.2)**	**(82.3)**	**(1,144.4)**
Total financial liabilities	**38,979.8**	**399.2**	**3,870.8**	**10,179.1**	**957.3**	**54,386.2**

Bank and Company At 31 December 2021	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
Financial liabilities measured at amortised cost:						
Customer deposits	34,251.0	154.2	798.4	762.9	–	35,966.5
Borrowings from central banks	–	13.8	–	5,537.6	–	5,551.4
Debt securities in issue	–	5.4	516.4	1,224.7	504.1	2,250.6
Subordinated liabilities	–	2.6	7.8	333.6	–	344.0
Lease liabilities	0.2	5.1	15.9	70.3	79.3	170.8
Other financial liabilities	193.6	–	–	–	–	193.6
Loan commitments	3,926.7	285.6	1,977.8	44.7	232.6	6,467.4
	38,371.5	466.7	3,316.3	7,973.8	816.0	50,944.3
Derivative financial instruments - outflows	6.6	24.4	97.3	470.8	168.1	767.2
Derivative financial instruments - inflows	(0.7)	(10.4)	(54.4)	(288.4)	(110.6)	(464.5)
Total financial liabilities	38,377.4	480.7	3,359.2	8,156.2	873.5	51,247.0

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

20. Capital resources

The Bank maintains capital resources which exceed regulatory requirements and which seek to support the strategic growth of the business, and ensure that it is able to absorb losses under stressed conditions. Capital risk is managed under a framework where risk appetite is set and approved annually by the Board. A series of metrics is used to monitor capital against early warning indicators with regular reporting in place to update and inform senior management. The table below presents the Bank's regulatory capital resources.

	Bank 2022 £ million	Bank 2021 £ million	Company 2022 £ million	Company 2021 £ million
Shareholder's equity	**1,929.8**	1,866.4	**1,924.7**	1,866.4
Regulatory deductions	**(149.8)**	(136.6)	**(144.7)**	(136.6)
Common Equity Tier 1/Total Tier 1 capital	**1,780.0**	1,729.8	**1,780.0**	1,729.8
Tier 2 capital	**326.0**	305.9	**326.0**	305.9
Total capital resources	**2,106.0**	2,035.7	**2,106.0**	2,035.7

Notes to the financial statements

Managing financial risk (continued)

21. Market risk

Definition and exposure

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

Management and measurement

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

Board risk appetite is set against a 12 month view of the sensitivity of net interest income to a 100 basis point, instantaneous, parallel shock to interest rates, for all currencies and maturities. The balance sheet and net interest income is simulated using actual point in time positions combined with the latest forecast assumptions for balances and margins. At 31 December 2022, the projected change in 12 month net interest income in response to an immediate parallel shift in all relevant interest rates, market and administered, would be an increase of £50.4 million from a 100bps increase in rates, and a decrease of £28.7 million from a 100bps decrease. The measure assumes all interest rates, for all currencies and maturities, move at the same time and by the same amount.

At 31 December 2021, sensitivity was assessed using +/- 25 basis points, consistent with the lower and less volatile interest rate environment at that time. The projected change in 12 month net interest income in response to an immediate parallel shift in all relevant interest rates, market and administered, would be an increase of £12.5 million from a 25bps increase in rates, and an increase £0.9 million from a 25bps decrease.

Derivative financial instruments

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

Bank	2022				2021			
Derivative financial instruments not in hedge accounting relationships	**Contract/ notional amount £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Gain/(loss) recognised in profit or loss £ million**	**Contract/ notional amount £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Gain(loss) recognised in profit or loss £ million**
Interest rate swaps	**31,652.6**	**1,158.7**	**(1,252.4)**	**(8.1)**	24,964.2	168.4	(156.5)	(2.5)
Total	**31,652.6**	**1,158.7**	**(1,252.4)**	**(8.1)**	24,964.2	168.4	(156.5)	(2.5)

Company	2022				2021			
Derivative financial instruments not in hedge accounting relationships	**Contract/ notional amount £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Gain/(loss) recognised in profit or loss £ million**	**Contract/ notional amount' £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Gain(loss) recognised in profit or loss £ million**
Interest rate swaps	**31,652.6**	**1,073.2**	**(1,252.4)**	**(13.2)**	24,964.2	168.4	(156.5)	(2.5)
Total	**31,652.6**	**1,073.2**	**(1,252.4)**	**(13.2)**	24,964.2	168.4	(156.5)	(2.5)

Notes to the financial statements

Managing financial risk (continued)

21. Market risk (continued)

Bank and Company	2022				2021			
Hedging derivative financial instruments	**Contract/ notional amount £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Change in fair value used for calculating hedge ineffectiveness £ million**	**Contract/ notional amount £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Change in fair value used for calculating hedge ineffectiveness £ million**
(Fair value hedges)								
Interest rate risk								
Interest rate swaps	**22,118.0**	**1,429.5**	**(301.5)**	**971.4**	21,947.4	235.6	(136.3)	174.9
(Cash flow hedges)								
Interest rate and credit risk								
Forward settlement contracts	**210.0**	**10.2**	**–**	**(8.9)**	200.0	2.3	(0.5)	12.1
Interest rate risk								
Interest rate swaps	**884.0**	**126.2**	**–**	**(54.6)**	175.0	6.6	–	11.8
Total	**23,212.0**	**1,565.9**	**(301.5)**	**907.9**	22,322.4	244.5	(136.8)	198.8

Risk management

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

TSB transacts derivatives largely to economically hedge interest rate risk. TSB hedges SONIA benchmark interest rate risk using both fair value hedges and cash flow hedges. As a result of TSB's dynamic hedging strategies described below, the loss on derivatives at fair value through profit or loss in respect of interest rate risk of £8.1 million (2021: £1.7 million loss) should be considered in conjunction with the gain of £7.1 million (2021: £4.8 million gain) from the amortisation of accumulated adjustments on the hedged items for which hedge accounting no longer applies.

Hedge accounting overview

The profile of interest risk being managed is dynamic, changing in response to business activity and is economically hedged with derivatives. Where natural offsets occur, these derivatives are not designated in hedge accounting relationships. The remaining derivatives may be designated in a hedge accounting relationship to minimise profit volatility.

Hedge relationships are considered effective where changes in the hedged item offset changes in the hedging instrument to within an 80% to 125% ratio. Effectiveness tests are performed at inception and on a monthly basis using either dollar offset, linear regression or critical terms match, depending on the nature of the hedged items. Ineffectiveness arising on hedge relationships can arise due to a number of factors which include basis mismatch, maturity mismatch, credit valuation adjustments and cash flow timing mismatch between the hedged item and hedging instrument.

Macro fair value hedge accounting – fixed rate mortgages and demand deposits

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

Micro fair value hedge accounting – subordinated debt and debt securities

The Bank has issued fixed rate subordinated debt and purchased hold-to-collect and hold-to-collect and sell fixed rate debt securities as part of its Treasury management strategy, and these are hedged with interest rate swaps and designated in a fair value hedge.

Notes to the financial statements

Managing financial risk (continued)

21. Market risk (continued)

Hedge accounting overview (continued)

Cash flow hedge accounting – forward bond sales
TSB seeks to minimise interest rate and credit risk arising on purchased hold to collect and sell debt securities, using forward settlement contracts. The sales proceeds represent a forecast transaction which is hedged by the forward contract. At 31 December 2022, forward settlement agreements with a notional amount of £210.0 million (2021: £200.0 million) were expected to mature within one year (2021: within one year) at a price of 82% of the notional amount (2021: 114%).

Cash flow hedge accounting – floating rate debt securities in issue
Interest rate risk on issued floating rate debt securities in issue is hedged using interest rate swaps that exchange floating rate cash flows for fixed rate cash flows. At 31 December 2022, £884.0 million (2021: £185.0 million) of floating rate debt securities in issue were designated in cash flow hedge relationships, of which cash flows in respect of £300.0 million (2021: £nil) were expected to mature within five years, and cash flows in respect of £584.0 million (2021: £185.0 million) were expected to mature after ten years.

Exposures covered by hedging accounting strategies
The following table contains details of the hedged exposures covered by The Bank's hedging strategy.

Bank and Company 2022	Risk type	Carrying amount of hedged item assets/(liability) £ million	Accumulated fair value hedge adj. on hedged item £ million	Balance sheet line item that includes the hedged item	Change in fair value for calculating hedge ineffectiveness £ million	Cash flow hedge reserve continuing hedges £ million
Fair value hedges						
Portfolio hedged risk:						
Demand deposits	Interest rate	**(6,751.0)**	**321.3**	**Customer deposits**	**276.1**	**n/a**
Fixed rate mortgages	Interest rate	**11,598.9**	**(542.8)**	**Loans & adv to customers**	**(461.1)**	
Individual hedged risk:						
Subordinated liabilities	Interest rate	**(265.4)**	**34.7**	**Subordinated liabilities**	**26.4**	**n/a**
Debt securities	Interest rate	**348.4**	**–**	**Financial assets at FVOCI**	**(184.8)**	**n/a**
Debt securities	Interest rate	**1,407.5**	**(688.2)**	**Financial assets at amortised cost**	**(631.7)**	**n/a**
					(975.1)	
Cash flow hedges						
Debt securities	Interest rate/credit	**161.2**	**n/a**	**Financial assets at FVOCI**	**54.6**	**10.2**
Debt securities in issue	Interest rate	**884.0**	**n/a**	**Debt securities in issue**	**8.9**	**46.1**
					63.5	**56.3**
2021						
Fair value hedges						
Portfolio hedged risk:						
Demand deposits	Interest rate	(6,512.4)	63.6	Customer deposits	179.2	n/a
Fixed rate mortgages	Interest rate	12,332.7	(109.3)	Loans & adv to customers	(183.4)	n/a
Individual hedged risk:						
Subordinated liabilities	Interest rate	(291.8)	8.3	Subordinated liabilities	11.2	n/a
Debt securities	Interest rate	841.0	–	Financial assets at FVOCI	(92.3)	n/a
Debt securities	Interest rate	1,921.8	(56.5)	Financial assets at amortised cost	(87.7)	n/a
					(173.0)	
Cash flow hedges						
Debt securities	Interest rate/credit	228.0	n/a	Financial assets at FVOCI	(11.8)	1.7
Debt securities in issue	Interest rate	185.0	n/a	Debt securities in issue	(12.2)	(10.7)
					(24.0)	(9.0)

The amount of fair value hedge adjustments remaining on the balance sheet relating to hedges which have been de-designated is £119.6 million (2021: £110.4 million).

Managing financial risk (continued)

21. Market risk (continued)

Hedge accounting ineffectiveness

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

Bank and Company					Amounts reclassified from reserves to P&L as:	
2022	Risk type	Hedge ineffectiveness recognised in P&L £ million	Gain/(loss) recognised in OCI £ million	P&L line item that includes hedge ineffectiveness	Hedged item affected P&L £ million	P&L line item that includes reclassified amount £ million
Fair value hedges	Interest rate	**(3.7)**	**–**	Gains from hedge accounting	**n/a**	n/a
Cash flow hedges	Interest rate / credit risk	**–**	**8.9**	n/a	**(0.5)**	Other income
Cash flow hedges	Interest rate	**0.8**	**54.6**	Gains from hedge accounting	**2.2**	Other income
		(2.9)	**63.5**		**1.7**	
2021						
Fair value hedges	Interest rate	(2.0)	n/a	Gains from hedge accounting	n/a	n/a
Cash flow hedges	Interest rate / credit risk	–	12.2	n/a	(8.2)	Other income
Cash flow hedges	Interest rate	(0.8)	11.8	Gains from hedge accounting	2.8	Other income
		(2.8)	24.0		(5.4)	

Gains from hedge accounting in the income statement of £4.2 million (2021: £(2.4) million of losses) comprise hedge ineffectiveness of £(2.9) million loss (2021: £2.8 million gain) and £7.1 million gain (2021: £(5.2) million loss) from amortisation of de-designated cash flow hedges and macro fair value hedge adjustments on hedged items for which hedge accounting had previously been discontinued.

Reconciliation of reserves in respect of hedge accounting

Bank and Company	2022 Fair value reserve £ million	2022 Cash flow hedge reserve £ million	2021 Fair value reserve £ million	2021 Cash flow hedge reserve £ million
Balance as at 1 January	**11.1**	**(6.6)**	11.6	(20.2)
Amounts recognised in other comprehensive income:				
Fair value hedges of interest rate risk				
Changes in fair value of purchased debt securities	**(202.1)**	**n/a**	(86.1)	n/a
Accumulated fair value hedge adjustment	**184.8**	n/a	92.3	n/a
	(17.3)	n/a	6.2	n/a
Net amounts reclassified to profit or loss	(6.3)	n/a	(7.0)	n/a
Taxation	**6.4**	n/a	0.3	n/a
Cash flow hedges of interest rate and credit risk				
Effective portion of changes in fair value of forward contracts	**n/a**	**8.9**	n/a	12.2
Amounts reclassified from reserves to profit or loss	**n/a**	**(0.5)**	n/a	(8.2)
Taxation	**n/a**	**(2.3)**	n/a	(1.0)
Cash flow hedges of interest rate				
Effective portion of changes in fair value of interest rate swaps	**n/a**	**54.6**	n/a	11.8
Amounts reclassified from reserves to profit or loss	**n/a**	**2.2**	n/a	2.8
Taxation	**n/a**	**(15.9)**	n/a	(4.0)
Balance as at 31 December	**(6.1)**	**40.4**	11.1	(6.6)

Notes to the financial statements

Managing financial risk (continued)

21. Market risk (continued)

Offsetting financial assets and financial liabilities

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

Bank At 31 December 2022	Gross amounts £ million	Amounts offset[1] £ million	Net amounts reported on the balance sheet £ million	Related amounts where set off in the balance sheet is not permitted: Related financial instrument amounts not offset £ million	Related amounts where set off in the balance sheet is not permitted: Cash collateral received/ pledged[2] £ million	Potential Net amount £ million
Derivative financial assets	**2,724.6**	**–**	**2,724.6**	**(1,354.5)**	**(960.7)**	**409.4**
Reverse repurchase agreements	**750.0**	**(750.0)**	**–**	**–**	**–**	**–**
	3,474.6	**(750.0)**	**2,724.6**	**(1,354.5)**	**(960.7)**	**409.4**
Derivative financial liabilities	**1,553.9**	**–**	**1,553.9**	**(1,354.5)**	**(198.8)**	**0.6**
Repurchase agreements	**1,110.0**	**(750.0)**	**360.0**	**(360.0)**	**–**	**–**
	2,663.9	**(750.0)**	**1,913.9**	**(1,714.5)**	**(198.8)**	**0.6**
At 31 December 2021						
Derivative financial assets	412.9	–	412.9	(276.3)	(136.2)	0.4
Derivative financial liabilities	293.3	–	293.3	(276.3)	(17.0)	–

(1) At 31 December 2022, TSB had entered into £750.0 million of repurchase agreements that transferred legal title of certain Duncan 2022 retained notes in return for cash, together with an agreement to repurchase the assets at a later date and at a predetermined price. Concurrently, TSB entered into £750.0 million of reverse repurchase agreements with the same counterparties as the repurchase agreement. These reverse repurchase agreements transferred legal title of certain UK gilts to TSB, in return for the payment of cash, together with an agreement for TSB to sell the UK gilts at a later date and at a predetermined price.

(2) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value and this amount is limited to the net balance sheet exposure by counterparty in order to exclude any over collateralisation. The collateral presented above includes non-cash collateral received of £111.1 million (2021: £nil) and non-cash collateral pledged of £0.8 million (2021: £nil)

Company At 31 December 2022	Gross amounts £ million	Amounts offset £ million	Net amounts reported on the balance sheet £ million	Related amounts where set off in the balance sheet is not permitted: Related financial instrument amounts not offset £ million	Related amounts where set off in the balance sheet is not permitted: Cash collateral received/ pledged[1] £ million	Potential Net amount £ million
Derivative financial assets	**2,639.1**	**–**	**2,639.1**	**(1,354.5)**	**(849.6)**	**435.0**
Reverse repurchase agreements	**750.0**	**(750.0)**	**–**	**–**	**–**	**–**
	3,389.1	**(750.0)**	**2,639.1**	**(1,354.5)**	**(849.6)**	**435.0**
Derivative financial liabilities	**1,553.9**	**–**	**1,553.9**	**(1,354.5)**	**(198.8)**	**0.6**
Repurchase agreements	**1,110.0**	**(750.0)**	**360.0**	**(360.0)**	**–**	**–**
	2,663.9	**(750.0)**	**1,913.9**	**(1,714.5)**	**(198.8)**	**0.6**
At 31 December 2021						
Derivative financial assets	412.9	–	412.9	(276.3)	(136.2)	0.4
Derivative financial liabilities	293.3	–	293.3	(276.3)	(17.0)	–

(1) At 31 December 2022, TSB had entered into £750.0 million of repurchase agreements that transferred legal title of certain Duncan 2022 retained notes in return for cash, together with an agreement to repurchase the assets at a later date and at a predetermined price. Concurrently, TSB entered into £750.0 million of reverse repurchase agreements with the same counterparties as the repurchase agreement. These reverse repurchase agreements transferred legal title of certain UK gilts to TSB, in return for the payment of cash, together with an agreement for TSB to sell the UK gilts at a later date and at a predetermined price.

(2) Collateral amounts (cash and non-cash financial collateral) are reflected at their fair value and this amount is limited to the net balance sheet exposure by counterparty in order to exclude any over collateralisation. The collateral amount presented includes non-cash collateral pledged of £0.8 million (2021: £nil).

Notes to the financial statements

Other important disclosures

Accounting policies relevant to this section

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

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

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

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

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

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

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

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

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

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

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

Notes to the financial statements

Other important disclosures (continued)

Accounting policies relevant to this section (continued)

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

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

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

22. Shareholder's equity

Bank	**Share capital £ million**	**Share premium £ million**	**Capital reserve £ million**	**Fair value reserve £ million**	**Cash flow hedging reserve £ million**	**Retained profit £ million**
Balance at 1 January 2021	79.4	195.6	412.8	11.6	(20.2)	1,045.7
Net change in fair value reserve	–	–	–	(0.5)	–	–
Net change in cash flow hedging reserve	–	–	–	–	13.6	–
Profit for the year	–	–	–	–	–	128.4
At 31 December 2021	**79.4**	**195.6**	**412.8**	**11.1**	**(6.6)**	**1,174.1**
Net change in fair value reserve	**–**	**–**	**–**	**(17.2)**	**–**	**–**
Net change in cash flow hedging reserve	**–**	**–**	**–**	**–**	**47.0**	**–**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**100.6**
Dividend paid				**–**	**–**	**(67.0)**
At 31 December 2022	**79.4**	**195.6**	**412.8**	**(6.1)**	**40.4**	**1,207.7**

Company	**Share capital £ million**	**Share premium £ million**	**Capital reserve £ million**	**Fair value reserve £ million**	**Cash flow hedging reserve £ million**	**Retained Profit Restate £ million**
At 1 January 2021	79.4	195.6	412.8	11.6	(20.2)	1,045.7
Net change in fair value reserve	–	–	–	(0.5)	–	–
Net change in cash flow hedging reserve	–	–	–	–	13.6	–
Profit for the year	–	–	–	–	–	128.4
At 31 December 2021	**79.4**	**195.6**	**412.8**	**11.1**	**(6.6)**	**1,174.1**
Net change in fair value reserve	**–**	**–**	**–**	**(17.2)**	**–**	**–**
Net change in cash flow hedging reserve	**–**	**–**	**–**	**–**	**47.0**	**–**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**95.5**
Dividend paid	**–**	**–**	**–**	**–**	**–**	**(67.0)**
At 31 December 2022	**79.4**	**195.6**	**412.8**	**(6.1)**	**40.4**	**1,202.6**

At 31 December 2022, TSB Bank plc had in issue 7,945,000,100 (2021: 7,945,000,100) one pence ordinary shares authorised, allotted and fully paid up.

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

Notes to the financial statements

Other important disclosures (continued)

23. Contingent liabilities

Significant judgement

Conduct

As explained in note 29 on page 81, management and the FCA are investigating conduct related matters in TSB's collection and recoveries function for which a provision covering the estimated redress costs has been recognised. It is not, however, currently possible to conclude if any regulatory penalty will be levied, or the timing of any potential penalty, and therefore no costs for an estimated penalty have been recognised in these financial statements.

More broadly, during the ordinary course of business, TSB may be subject to other complaints and threatened or actual legal proceedings brought by customers that may result in legal and regulatory reviews, challenges, investigations and enforcement actions. For example, TSB is currently managing certain customer complaints, court claims and an application for a group litigation order in relation to the case management of those claims, relating to the portfolio of ex-Northern Rock residential mortgages (and linked unsecured loans) acquired from Cerberus Capital Management group (the Whistletree Portfolio). The Group intends to defend the claims and the application for a group litigation order rigorously.

Any such material cases are periodically reassessed with the assistance of external professional advisers, where appropriate, to determine the likelihood of incurring a liability. TSB does not expect the ultimate resolution of any current complaints, threatened or actual legal proceedings, regulatory or other matters to have a material adverse impact on its financial position in relation to any additional issues not explicitly disclosed above.

24. Related party transactions

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

(i) Key management personnel

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

Bank and Company	2022 £ 000	2021 £ 000
Short term employee benefits	**9,337**	9,191
Post-employment benefits	**676**	802
Share-based payments	**998**	574
Total	**11,011**	10,567

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

Bank and Company	2022 £ 000	2021 £ 000
Loans		
At 1 January	**671**	33
Advances (includes key management personnel appointed during the year)	**838**	793
Interest charged during the year	**16**	1
Repayments made during the year (including key management personnel resigned during the year)	**(138)**	(156)
At 31 December	**1,387**	671

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

Notes to the financial statements

Other important disclosures (continued)

24. Related party transactions (continued)

(i) Key management personnel (continued)

Bank and Company	2022 £ 000	2021 £ 000
Deposits		
At 1 January	**247**	1,913
Deposits made during the year (includes key management personnel appointed during the year)	**649**	5,577
Interest expense on deposits	**–**	1
Withdrawals made during the year (including key management personnel resigned during the year)	**(780)**	(7,244)
At 31 December	**116**	247

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

(ii) Transactions and balances with TSB Group companies

Amounts payable to TSB Banking Group plc, the Company's immediate parent company, totalled £53.9 million (2021: £1.1 million) primarily reflecting amounts payable in respect of the 2022 interim dividend of £67.0 million, offset by cumulative costs recoverable from TSB Banking Group plc of £13.1 million (2021: £17.2 million asset), primarily comprising of recharged operating expenses.

Amounts due from TSB Banking Group Employee Share Trust (EST) totalled £1.6 million (2021: £1.6 million) reflecting an interest free loan to enable the EST to acquire Sabadell shares in respect of the Bank's share based compensation schemes.

Amounts due from structured entity subsidiaries to the Company totalled £240.3 million (2021: £56.1 million) comprising of balances in respect of covered bond and securitisation programmes.

(iii) Transactions and balances with Sabadell Group companies

Operational IT costs

Operating expenses of £53.9 million (2021: £59.0 million) were incurred in respect of services provided by Sabis, TSB's ultimate parent company's IT supplier, under the Outsourced Services Agreement (OSA) for running and developing the banking platform. At 31 December 2022, the aggregate liability to Sabis was £6.0 million (2021: £6.9 million) (note 30 on page 82).

Senior unsecured debt securities

In December 2022, TSB Bank plc issued £250 million of floating rate notes with a maturity date of December 2026 to its parent company, TSB Banking Group plc, at an issue price of 100% of the principal amount. The notes pay interest at SONIA plus 3.4%.

In June 2022, the Company issued £450.0 million floating rate notes, due to mature in June 2027, to its parent company, TSB Banking Group plc, to satisfy MREL requirements. These were issued at a price of 100% of the principal amount. The notes pay interest at SONIA plus 2.45% payable quarterly in arrears. These notes replaced the £450.0 million floating rate notes issued by the Company to its parent in December 2020 and which paid interest at SONIA plus 2.1%. The Company exercised its option to redeem these notes in June 2022.

Interest expense of £18.0 million (2021: £9.7 million) was recognised and £2.4 million was payable at 31 December 2021 (2021: £0.1 million).

Subordinated liabilities

In March 2021, TSB Bank plc issued £300.0 million fixed-to-floating rate callable subordinated Tier 2 capital notes, due to mature in March 2031, to its parent company, TSB Banking Group plc. These were issued at a price of 100% of the principal amount. The notes pay interest at a fixed rate of 3.449% per annum payable quarterly in arrears. TSB has the option to redeem these notes in March 2026, subject to approval of the PRA. Interest expense of £10.3 million (2021: £7.8 million) was recognised and £0.1 million was payable at 31 December 2022 (2021: £0.1 million).

Notes to the financial statements

Other important disclosures (continued)

24. Related party transactions (continued)

(iii) Transactions and balances with Sabadell Group companies (continued)

Other transactions and balances
Sabadell acts as an intermediary for TSB in respect of international payments and TSB has nostro accounts as a result of this arrangement which had a net balance due from Sabadell of £9.4 million (2021: £2.1 million). Sabadell acts as guarantor to TSB's borrowings under the TFSME. Under this arrangement guarantee fees of £11.1 million (2021: £5.2 million) were recognised and £2.9 million (2021: £2.5 million) was payable at 31 December 2022.

(iv) Subsidiary undertakings
The following entities are accounted for as subsidiary companies of the Company as it exercises control of each entity under IFRS 10 *Consolidated Financial Statements.:*

Registered office: 1 Bartholomew Lane, London, United Kingdom, EC2N 2AX
- TSB Covered Bonds LLP;
- TSB Covered Bonds (LM) Limited; and
- TSB Covered Bonds (Holdings) Limited.

Registered office: 10th Floor, 5 Churchill Place, London, United Kingdom, E14 5HU
- Duncan Holdings 2022-1 Limited (and its subsidiary Duncan Funding 2022-1 plc).

Notes to the financial statements

Other important disclosures (continued)

25. Property and equipment

Bank and Company	Property £ million	Equipment £ million	Property Right of use leasing asset £ million	Total £ million
Cost				
At 1 January 2021	234.0	122.8	168.7	525.5
Additions	16.9	29.6	12.8	59.3
Disposals	(78.4)	(60.1)	(11.0)	(149.5)
Lease term remeasurement (note 26)	–	–	60.0	60.0
At 31 December 2021	**172.5**	**92.3**	**230.5**	**495.3**
Additions	**20.7**	**29.1**	**3.7**	**53.5**
Disposals	**(34.4)**	**(24.7)**	**(10.9)**	**(70.0)**
Lease term remeasurement (note 26)	**–**	**–**	**(2.9)**	**(2.9)**
At 31 December 2022	**158.8**	**96.7**	**220.4**	**475.9**
Accumulated depreciation				
At 1 January 2021	134.3	79.5	52.8	266.6
Depreciation charge for property and equipment (note 14)	22.4	15.0	–	37.4
Depreciation charge for right of use asset (note 14)	–	–	25.1	25.1
Disposals	(69.8)	(56.0)	(8.3)	(134.1)
At 31 December 2021	**86.9**	**38.5**	**69.6**	**195.0**
Depreciation charge for property and equipment (note 14)	**19.0**	**15.7**	**–**	**34.7**
Depreciation charge for right of use asset (note 14)	**–**	**–**	**17.3**	**17.3**
Disposals	**(31.0)**	**(16.0)**	**(11.6)**	**(58.6)**
At 31 December 2022	**74.9**	**38.2**	**75.3**	**188.4**
Carrying amount				
At 31 December 2021	85.6	53.8	160.9	300.3
At 31 December 2022	**83.9**	**58.5**	**145.1**	**287.5**

At 31 December 2022, property held for sale totalled £0.5 million (2021: £1.6 million). The net book value represented the recoverable amount and no impairment was required.

26. Lease liabilities

The Bank's leasing activity primarily reflects leases of various offices and bank branch properties. These lease arrangements will often contain renewal options and rent escalation clauses, although the effect of these is not material. No arrangements have been entered into for contingent rental payments. The tables below set out details of the amounts recognised in the financial statements in respect of leases:

Bank and Company Lease liability	Property 2022 £ million	Property 2021 £ million
Balance at 1 January	**163.5**	123.3
Additions	**3.7**	0.4
Lease term remeasurement	**(2.9)**	60.0
Interest expense for the year	**1.3**	2.6
Lease payments made in the year	**(19.7)**	(22.8)
Carrying amount at 31 December	**145.9**	163.5

As part of a wider strategic property review, during 2021 the lease terms of relevant properties were reassessed. This resulted in an increase in the lease liability of £60.0 million and a corresponding increase in the associated right of use assets (note 25). The estimation of lease term required judgement to assess the effect of term extensions that resulted in certain lease accounting terms exceeding the initial contractual lease period. An increase or decrease in the estimated lease term of one year, applied uniformly across the portfolio, would have increased/decreased the lease liability, and the corresponding right of use asset, by £8.0 million.

Notes to the financial statements

Other important disclosures (continued)

27. Intangible assets

Bank and Company	2022 £ million	2021 £ million
Cost		
At 1 January	**94.9**	66.4
Additions	**17.5**	32.1
Disposals	**(1.7)**	(3.6)
At 31 December	**110.7**	94.9
Accumulated amortisation		
At 1 January	**22.8**	16.9
Amortisation charge for the year (note 14)	**14.0**	7.7
Disposals	**(1.7)**	(1.8)
At 31 December	**35.1**	22.8
Carrying amount	**75.6**	72.1

28. Other assets

	Bank 2022 £ million	Bank 2021 £ million	Company 2022 £ million	Company 2022 £ million
Prepayments	**34.5**	36.7	**34.5**	36.7
Accrued fee and commission income	**21.8**	19.8	**21.8**	19.8
Amounts recoverable under customer remediation indemnity	**9.9**	6.9	**9.9**	6.9
Other(1)	**15.8**	73.8	**14.7**	73.8
Amounts due from other TSB Group companies (note 24(ii))	**1.6**	18.8	**241.9**	74.9
Total other assets	**83.6**	156.0	**322.8**	212.1

(1) The reduction in Other primarily reflects the settlement of a migration related VAT recovery following finalisation of the matter.

29. Provisions

Bank and Company	Conduct provisions £ million	Restructuring provisions £ million	Credit impairment provisions £ million	Dilapidations provisions £ million	Total £ million
At 1 January 2022	**59.5**	**14.4**	**16.7**	**19.6**	**110.2**
Transfers(1)	**2.7**	**–**	**–**	**–**	**2.7**
Charge/(credit) to income statement(2)	**33.6**	**5.6**	**(2.8)**	**–**	**36.4**
Utilisation	**(7.2)**	**(13.3)**	**–**	**(3.8)**	**(24.3)**
At 31 December 2022	**88.6**	**6.7**	**13.9**	**15.8**	**125.0**

(1) Transfers reflect the reclassification of £2.7 million of amounts reimbursable by third parties as other assets.
(2) Charge to the income statement in respect of conduct provisions of £33.6 million relates to the £28.6 million reported as notable conduct charges in note 14 on page 53.

Significant estimates

Conduct provisions
In the course of its business, TSB is engaged in discussions with regulators on a range of matters and also receives complaints in connection with its past conduct and claims brought by or on behalf of customers. Where significant, provisions are held against the costs expected to be incurred in relation to these matters.

During the year ended 31 December 2022, a further £33.6 million was recognised in the Income Statement in respect of customer conduct matters which, combined with amounts accounted for on incurred basis, resulted in a total conduct charge in operating expenses of £37.2 million (2021: £2.2 million).

The unutilised balance of the provision at 31 December 2022 was £88.6 million (2021: £59.5 million). The most significant items are described overleaf.

Notes to the financial statements

Other important disclosures (continued)

29. Provisions (continued)

Significant estimate (continued)

Provision for the treatment of customers in Collection & Recoveries
During 2020, management and the FCA commenced a review of support treatments offered to some customers who are, or were, in arrears and being serviced by TSB's collections and recoveries department which has identified potentially impacted customers over a period from 2013 to 2020 who may have suffered either financial loss or distress and inconvenience. While the review is not yet complete, the assessment of the potential cost of customer redress, including compensatory interest, and related operational costs has been refined subsequently.

The remaining costs of redress are estimated to lie within a range of £66.5 million to £68.4 million (2021: £49.4 million to £56.6 million). A provision of £69.4 million (2021: £54.3 million) is carried and is expected to be utilised over the next year, partially offset by a recoverable amount of £2.3 million (2021: £nil). The key judgements to which the estimate is sensitive, and which are the primary drivers of the £1.9 million range in estimated cost, relate to estimates of the degree to which previously applied fees and charges have been already refunded resulting in a reduction in estimated costs.

Credit impairment provisions
Credit impairment provisions are in respect of off balance sheet lending commitments and primarily relates to provisions in respect of undrawn credit card limits and current account overdrafts. This provision is measured and managed as part of the overall assessment of expected credit losses. Sensitivity of total expected credit losses to alternative economic scenarios is set out in note 8 on page 45.

30. Other liabilities

Bank	2022 £ million	2021 £ million
Amounts payable to Sabadell Group companies (note 24(iii))	**6.0**	6.9
Amounts payable to other TSB Group companies (note 24(ii))	**53.9**	1.1
Accruals and deferred income	**106.2**	118.1
Share based payment liability	**8.3**	5.3
Other creditors	**64.4**	66.4
Total other liabilities	**238.8**	197.8

Company	2022 £ million	2021 £ million
Amounts payable to Sabadell Group companies (note 24)	**6.0**	6.9
Amounts payable to other TSB Group companies (note 24)	**53.9**	1.1
Accruals and deferred income	**106.2**	118.1
Share based payment liability	**8.3**	5.3
Other creditors	**64.0**	66.4
Total other liabilities	**238.4**	197.8

Notes to the financial statements

Other important disclosures (continued)

31. Notes to the consolidated cash flow statement

The table below presents the change in liabilities arising from financing activities.

Bank	Borrowings from central banks £ million	Debt securities in issue £ million	Subordinated liabilities £ million	Repurchase agreements £ million	Non customer funding £ million
At 1 January 2021	3,065.8	1,699.2	391.3	–	5,156.3
Additional borrowings from central banks	5,500.0	–	–	–	5,500.0
Repayment of borrowings from central banks	(3,065.0)	–	–	–	(3,065.0)
Issue of subordinated liabilities	–	–	300.0	–	300.0
Repayment of subordinated liabilities	–	–	(385.0)	-	(385.0)
Issuance of covered bonds	–	500.0	–	–	500.0
Non-cash movements	0.8	(0.1)	(14.5)	–	(13.8)
At 31 December 2021	**5,501.6**	**2,199.1**	**291.8**	**–**	**7,992.5**
Additional borrowings from central banks	**510.0**	**–**	**–**	**–**	**510.0**
Repayment of borrowings from central banks	**(510.0)**	**–**	**–**	**–**	**(510.0)**
Issue of senior unsecured debt securities	**–**	**700.0**	**–**	**–**	**700.0**
Repayment of senior unsecured debt securities	**–**	**(450.0)**	**–**	**–**	**(450.0)**
Repayment of covered bonds	**–**	**(500.0)**	**–**	**–**	**(500.0)**
Issue of repurchase agreements	**–**	**–**	**–**	**359.9**	**359.9**
Non-cash movements	**36.7**	**6.4**	**(26.4)**	**0.1**	**16.8**
At 31 December 2022	**5,538.3**	**1,955.5**	**265.4**	**360.0**	**8,119.2**

(1) Non-cash movements reflect changes in accrued interest, unamortised premiums and discounts and, in respect of subordinated liabilities, micro fair value hedge accounting adjustments.

Other important disclosures (continued)

31. Notes to the consolidated cash flow statement (continued)

Company

	Borrowings from central banks £ million	Debt securities in issue £ million	Subordinated liabilities £ million	Repurchase agreements £ million	Total non customer funding £ million
At 1 January 2021	3,065.8	1,699.2	391.3	–	5,156.3
Additional borrowings from central banks	5,500.0	–	–	–	5,500.0
Repayment of borrowings from central banks	(3,065.0)	–	–	–	(3,065.0)
Issue of subordinated liabilities	–	–	300.0	–	300.0
Repayment of subordinated liabilities	–	–	(385.0)	–	(385.0)
Issuance of covered bonds	–	500.0	–	–	500.0
Non-cash movements	0.8	(0.1)	(14.5)	–	(13.8)
At 31 December 2021	**5,501.6**	**2,199.1**	**291.8**	**–**	**7,992.5**
Additional borrowings from central banks	**510.0**	**–**	**–**	**–**	**510.0**
Repayment of borrowings from central banks	**(510.0)**	**–**	**–**	**–**	**(510.0)**
Issue of senior unsecured debt securities	**–**	**700.0**	**–**	**–**	**700.0**
Repayment of senior unsecured debt securities	**–**	**(450.0)**	**–**	**–**	**(450.0)**
Repayment of covered bonds	**–**	**(500.0)**	**–**	**–**	**(500.0)**
Issuance of repurchase agreements	**–**	**–**	**–**	**359.9**	**359.9**
Non-cash movements	**36.7**	**6.4**	**(26.4)**	**0.1**	**16.8**
At 31 December 2022	**5,538.3**	**1,955.5**	**265.4**	**360.0**	**8,119.2**

The following table presents further analysis of balances in the consolidated cash flow statement:

	Bank 2022 £ million	Bank 2021 £ million	Company 2022 £ million	Company 2021 £ million
Increase in loans to central banks	**(0.7)**	(22.7)	**(0.7)**	(22.7)
Increase in loans to credit institutions	**(103.1)**	(12.8)	**–**	–
Increase in loans and advances to customers	**(722.5)**	(4,070.2)	**(722.5)**	(4,070.2)
(Increase)/decrease in other advances	**(622.6)**	136.8	**(622.6)**	136.8
Net change in derivative financial instruments and fair value adjustment for portfolio hedged risk	**61.0**	(147.6)	**146.5**	(147.6)
Decrease/(increase) in other assets	**72.4**	18.6	**(110.7)**	5.7
Increase in customer deposits	**357.0**	1,591.2	**357.0**	1,591.2
Increase in other financial liabilities	**1,126.5**	141.9	**1,126.5**	141.9
Increase/(decrease) in provisions	**17.6**	(40.4)	**17.6**	(40.4)
Increase in other liabilities	**41.6**	0.7	**41.2**	0.8
Increase in dividend payable	**(67.0)**	–	**(67.0)**	–
Change in operating assets and liabilities	**160.2**	(2,404.5)	**165.3**	(2,404.5)
Depreciation and amortisation	**66.0**	70.2	**66.0**	70.2
Impairment losses on loans and advances to customers	**57.8**	2.6	**57.8**	2.6
Other non-cash items	**62.6**	39.2	**62.6**	39.2
Non-cash and other items	**186.4**	112.0	**186.4**	112.0
Analysis of cash and cash equivalents as shown in the balance sheet				
Cash	**87.9**	100.7	**87.9**	100.7
Balances with central banks	**5,141.2**	4,741.5	**5,141.2**	4,741.5
On demand deposits	**9.7**	8.9	**9.7**	8.9
Total cash and cash equivalents	**5,238.8**	4,851.1	**5,238.8**	4,851.1

Notes to the financial statements

Other important disclosures (continued)

32. Approval of the consolidated financial statements

These consolidated financial statements were approved by the Board of Directors on 31 January 2023.

The Company's ultimate parent company and ultimate controlling party is Banco de Sabadell, S.A. (incorporated in Spain), which is also the parent undertaking of the largest group of undertakings for which consolidated financial statements are drawn up and of which the Company is a member. TSB Banking Group plc is the parent undertaking of the smallest such group of undertakings for which consolidated financial statements are drawn up and of which the Company is a member. Copies of the consolidated annual report and accounts of Banco de Sabadell S.A. are expected to be available in due course from www.grupbancsabadell.com/en/.

Independent auditor's report to the members of TSB Bank plc

1 Our opinion is unmodified

We have audited the financial statements of TSB Bank plc ("the Company") for the year ended 31 December 2022 which comprise the consolidated balance sheet, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated cash flow statement, parent Company balance sheet, parent Company statement of changes in equity, parent Company cash flow statement, and the related notes, including the accounting policies.

In our opinion:

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

Basis for opinion

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

We were first appointed as auditor by the shareholders on 5 May 2020. The period of total uninterrupted engagement is for the three financial years ended 31 December 2022. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

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

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

Independent auditor's report to the members of TSB Bank plc (continued)

2 Key audit matters: our assessment of risks of material misstatement (continued)

	The risk	Our response
Expected credit losses on loans and advances to customers **Risk vs 2021: ▲** ***31 December 2022: £198.0 million*** ***(31 December 2021: £189.6 million)*** ***Refer to pages 38-40 (accounting policy) and note 8 (financial disclosures)***	***Subjective estimate*** The measurement of expected credit losses ('ECL') on loans and advances to customers involves significant judgements and estimates. A heightened risk of material misstatement of ECL continues to arise in the current year due to the increased judgement and estimation uncertainty as a result of the evolving ongoing macroeconomic uncertainties in 2022. The key areas where we identified greater levels of judgement and therefore increased levels of audit focus in the Group's estimation of ECL are: • **Economic scenarios** – IFRS 9 requires the Group to measure ECL on a forward-looking basis reflecting a range of future economic conditions. Significant judgement is applied in determining the economic scenarios used and the probability weightings assigned to each economic scenario, particularly in the current macroeconomic environment. • **Qualitative adjustments** – Adjustments to the model-driven ECL results are raised by the Group to address issues relating to model limitations, model responsiveness or emerging trends including those relating to the current macroeconomic environment. Certain adjustments are inherently uncertain and significant judgement is involved in estimating these amounts. • **Significant Increase in Credit Risk ('SICR')** – The criteria selected to identify a significant increase in credit risk is a key area of judgement within the Group's ECL calculation as these criteria determine whether a 12 month or lifetime provision is recorded. • **Model risks** – Inherently judgemental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD'). The LGD model used in the secured portfolio and the PD models used in the unsecured portfolios are the key drivers of the Group's ECL results and are therefore the most significant judgemental aspects of the Group's ECL modelling approach. The effect of these matters is that, as part of our risk assessment, we determined that the ECL on loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements disclose the sensitivities estimated by the Group (note 8). **Disclosure quality** The disclosures regarding the Group's application of IFRS 9 are key to explaining the key judgements and material inputs to the IFRS 9 ECL results.	We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described: **Test of details:** We recalculated the ECL measured for each of TSB's loan portfolios. We performed sample testing over key inputs, data and assumptions to assess the reasonableness of key aspects of the ECL calculations. **Our economic scenario expertise:** We involved our own economic specialists to assist us in assessing the appropriateness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them. We assessed the overall reasonableness of the economic scenarios in the context of the current macroeconomic environment by comparing the Group's scenarios to our own modelled scenarios. **Qualitative adjustments:** For each of the significant adjustments to the model-driven ECL results, we assessed the reasonableness of the adjustments by evaluating the key assumptions, inspecting the calculation methodology, tracing a sample of data used back to source data, and recalculating the qualitative adjustments. We also assessed the completeness of qualitative adjustments recognised including in response to model limitations, data limitations and the evolving macroeconomic outlook. **SICR**: We assessed the ongoing effectiveness of the SICR criteria and independently calculated the loans' stage for the Group's loans and advances. **Our financial risk modelling expertise:** We involved our own financial risk modelling specialists in evaluating the Group's IFRS 9 models. We used our knowledge of the Group and our experience of the industry that the Group operates in to independently challenge the appropriateness of the Group's IFRS 9 models. **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's overall ECL including in the context of the current macroeconomic environment. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgements and assumptions made was sufficiently clear. **Our results** The results of our testing were satisfactory, and we considered the ECL charge and provision recognised and the related disclosures to be acceptable (2021: acceptable).

Independent auditor's report to the members of TSB Bank plc (continued)

2 Key audit matters: our assessment of risks of material misstatement (continued)

	The risk	Our response
IT access, change management and operations **Risk vs 2021: ◄►**	**Control performance, data capture and integrity** The Group has historical issues with the design and implementation of controls within the Group's general IT control ('GITC') environment, specifically in relation to user access and change management. During 2022, the Group has established a revised IT risk and control framework and commenced the implementation of a new multi-year remediation plan. The Group's accounting and reporting processes are dependent on automated controls ('ACs', such as, data feeds or automated calculations) enabled by IT systems. These are then supported by GITCs, covering areas such as access and change management and batch processing, which ensure the integrity of the Group's IT systems. There is a risk that, if the GITCs are not effective, inappropriate access could be gained to IT applications and subsequent unauthorised changes made to the application or the related ACs. In addition, GITCs that are not effective could also affect the integrity of data stored on the IT systems and the effectiveness of automated and manual controls that use this data.	Our procedures included: **Control testing**: We tested the design, implementation and operating effectiveness of relevant controls over change management, batch processing and access management over privileged access rights. **Extended scope**: Where GITC deficiencies were identified, we assessed what additional testing procedures were necessary to mitigate any residual risk, including: • Whilst we were not able to rely on the associated GITCs, we decided to continue to place reliance on certain ACs by increasing the frequency with which we manually tested the operation of these ACs subject to audit from once to multiple times throughout the period. • We identified, tested and placed reliance on alternative manual controls which mitigated the same process risks as the ACs. • We performed incremental substantive procedures to address the same process risk as the relevant ACs. **Our results**: We identified certain ACs that we could rely on in our audit as a result of the additional testing performed as detailed above. For the remainder, we were not able to rely on the ACs, however, through the performance of the incremental procedures set out above, we have been able to reduce the audit risk relating to IT access, change management and operations to an acceptable level. (2021: We aligned our testing of GITCs to the Group's IT remediation project during the year and identified certain automated controls we could rely on in our audit. This was either because GITCs were effective or through the additional work described above, that the deficiencies identified had not impacted the specific automated control. As a result of our testing of the general IT control environment and through the performance of the incremental procedures, we have therefore been able to reduce the audit risk relating to IT access, change management and operations to an acceptable level). With regard to automated controls, we did not identify any significant deficiencies or material errors in the relevant data elements that we tested (2021: With regard to automated controls, we did not identify any significant deficiencies or material errors in the relevant data elements that we tested).

Independent auditor's report to the members of TSB Bank plc (continued)

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

Materiality for the Group financial statements as a whole was set at £10.0 million (2021: £10.0 million), determined with reference to a benchmark of Group total revenue, of which it represents 0.89% (2021: 1.02%). We consider total revenue to be the most appropriate benchmark as it provides a more stable measure year on year than Group profit before tax because of the significant fluctuations in profit before tax in recent years.

Materiality for the parent Company financial statements as a whole was set at £10.0 million (2021: £10.0 million), determined with reference to a benchmark of total revenue, of which it represents 0.89% (2021: 1.02%).

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

Performance materiality for the Group and parent Company was set at 65% (2021: 65%) of materiality for the financial statements as a whole, which equates to £6.5 million (2021: £6.5 million). The performance materiality percentage remains unchanged from last year as a result of continued IT control deficiencies identified and the Group's ongoing remediation of the IT control environment.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.5 million (2021: £0.5 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

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

The Group team performed the audit of the Group as if it was a single set of financial information. The audit was performed using the materiality and performance materiality levels set out above.

Independent auditor's report to the members of TSB Bank plc (continued)

4 Going concern

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

We used our knowledge of the Group, its industry, and the general economic environment to identify the inherent risks to its business model and analysed how those risks might affect the Group's and parent Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Group's and parent Company's available financial resources over this period were:

- the availability of funding and liquidity in the event of a market wide stress scenario; and
- the impact on regulatory capital in the event of an economic slowdown or recession.

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

We considered whether the going concern disclosure in the financial statements gives a full and accurate description of the directors' assessment of going concern.

Our conclusions based on this work:

- we consider that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate;
- we have not identified, and concur with the directors' assessment that there is not, a material uncertainty related to events or conditions that, individually or collectively, may cast significant doubt on the Group's or parent Company's ability to continue as a going concern for the going concern period; and
- we found the going concern disclosure on page 28 (basis of preparation) to be acceptable.

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

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

Identifying and responding to risks of material misstatement due to fraud

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

- Enquiring of directors, Internal Audit and inspection of policy documentation as to the Group and parent Company's high-level policies and procedures to prevent and detect fraud, including the Internal Audit function, and the Group and parent Company's channel for "whistleblowing", as well as whether they have knowledge of any actual, suspected or alleged fraud;
- Reading Board, Board Audit Committee and Risk Committee minutes;
- Considering remuneration incentive schemes and performance targets for management and directors;
- Using analytical procedures to identify any unusual or unexpected relationships; and
- Discussion with our own forensic professional regarding the identified fraud risks and the design of the audit procedures planned in response to these.

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

As required by auditing standards, and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, in particular:

- the risk that Group management may be in a position to make inappropriate accounting entries; and
- the risk of bias in accounting estimates and judgements such as expected credit losses on loans and advances to customers.

On this audit we do not believe there is a fraud risk related to revenue recognition because there is limited complexity in the calculation and recognition of revenue.

Independent auditor's report to the members of TSB Bank plc (continued)

5 Fraud and breaches of laws and regulations – ability to detect (continued)

We also identified a fraud risk related to estimation of expected credit losses, specifically relating to economic scenarios and qualitative adjustments in response to significant estimation that involves subjective judgements or are inherently uncertain. Further detail in respect of expected credit losses is set out in the key audit matter disclosures in section 2 of this report.

We also performed procedures including:

- Identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included those posted by individuals with privileged access and those posted and approved by the same user; and
- Assessing whether the judgements made in making accounting estimates are indicative of a potential bias.

We discussed with the Audit Committee matters related to actual or suspected fraud, for which disclosure is not necessary, and considered any implications for our audit.

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

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

As the Group is regulated, our assessment of risks involved gaining an understanding of the control environment including the entity's procedures for complying with regulatory requirements.

We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the Group is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance, through the imposition of fines or litigation or the loss of the Group and parent Company's license to operate. We identified the following areas as those most likely to have such an effect: specific areas of regulatory capital and liquidity, conduct, money laundering and financial crime and certain aspects of company legislation recognising the financial and regulated nature of the Group and parent Company's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

For customer conduct matters discussed in note 29, our procedures included inquiries of internal counsel, external counsel, and inspection of correspondence with the regulator.

For the joint regulatory investigation discussed in note 14, our procedures included review of regulatory findings, enquiries of internal counsel and inspection of the payment of the fine levied by the regulators.

We discussed with the Audit Committee matters related to actual or suspected breaches of laws and regulations, for which disclosure is not necessary, and considered any implications for our audit.

Independent auditor’s report to the members of TSB Bank plc (continued)

5 Fraud and breaches of laws and regulations – ability to detect (continued)

Context of the ability of the audit to detect fraud or breaches of law or regulation

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it.

In addition, as with any audit, there remained a higher risk of non-detection of fraud, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

6 We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors’ report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors’ report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

7 We have nothing to report on the other matters on which we are required to report by exception

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

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

We have nothing to report in these respects.

Independent auditor's report to the members of TSB Bank plc (continued)

8 Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on pages 26 and 27, the directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

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

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

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

Pamela McIntyre (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
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31 January 2023

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