TSB Bank plc
Annual Report and Accounts 2021

Registered in Scotland
Company Number: SC095237

TSB Bank plc

Annual report and consolidated financial statements
For the year ended 31 December 2021

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[(1)] (appointed 1 November 2021)
	Richard Meddings[(1)] (resigned 29 November 2021)
Executive Directors:	Robin Bulloch[(2)] (Interim Chief Executive) (appointed 16 December 2021)
	Debbie Crosbie (Chief Executive) (resigned 2 December 2021)
	Declan Hourican (Chief Financial Officer) (appointed 13 September 2021)
	Ralph Coates (Chief Financial Officer) (resigned 13 September 2021)
Independent Non-executive Directors:	Adam Banks (appointed 8 February 2021)
	Paulina Beato (resigned 21 March 2021)
	Elizabeth Chambers
	Lynne Peacock (Senior Independent Director)
	Mark Rennison
	Andy Simmonds
	Polly Williams (resigned 5 March 2021)
Non-executive Directors:	César González-Bueno (resigned 18 May 2021)
	Alicia Reyes (appointed 18 May 2021)
	Tomás Varela
	David Vegara
Company Secretary:	Keith Hawkins

(1) Both Nick Prettejohn and Richard Meddings were independent on their appointment to the role of Chairman. Nick Prettejohn was appointed as a Non-executive Director on 1 November 2021 and succeeded Richard Meddings as Chairman on 29 November 2021.
(2) Robin Bulloch was appointed as the Interim Chief Executive on 3 December 2021 and as an Executive Director on 16 December 2021, subject to regulatory approval.

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

Strategic report

Review of business performance

Introduction
This has been a transformational year for TSB with strong growth and progress delivered. While 2020 was defined by the response to the pandemic, 2021 was about getting back to growth and delivering TSB's Money Confidence purpose. TSB delivered an impressive improvement in financial performance and a management profit in every quarter of the year. Both lending and deposits increased, costs were reduced, and capital and liquidity remain strong and stable.

Leadership Changes
In November 2021, Nick Prettejohn became TSB Chairman, replacing Richard Meddings. The Board thanks Richard for his outstanding leadership over the past four years. Richard has left the business in very good shape. The Bank has a well-defined strategy for growth, and an experienced and high-performing management team, who are executing that strategy with vigour.

In December 2021, Robin Bulloch became the Interim Chief Executive and Executive Director, replacing Debbie Crosbie, who resigned from this role to take up a Chief Executive role elsewhere. Everyone at TSB is grateful for the part Debbie played in the turnaround of the business and she leaves with the Board's thanks and very best wishes for the future.

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

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

In 2021 we delivered:
- outstanding growth in mortgages, breaking all previous records for TSB, including helping more than 16,000 first-time buyers to get their foot on the first rung of the property ladder;
- the new Spend & Save Plus current account – with additional features to help our customers manage their money;
- partnerships that increase our customers' Money Confidence, including Wealthify and Freedom Finance; and
- 135 branch upgrades and over 40 new 'pop-up' services helping to transform customer service in our branch network.

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

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

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

TSB has reported a statutory profit before tax of £155.5 million, compared to a loss before tax of £200.5 million in 2020. The turnaround is underpinned by the improved economic outlook, execution of TSB's strategy and our response to COVID-19.

A highlight of these results is our continued balance sheet strength with a record £9.2 billion (2020: £6.1 billion) of gross mortgage lending supported by buoyant mortgage demand, driving a £4.1 billion or 12.2% increase in total lending balances to £37.4 billion. Our customer lending portfolios have remained resilient and the economic outlook has continued to improve, leading to a reduction in credit impairment charges to £0.1 million (2020: £164.0 million) that will not be repeated in 2022. Deposit balances have also grown, with an increase of 4.6% to £36.0 billion. We have also continued to simplify TSB's business with operating expenses decreasing 14.7% to £827.3 million. This primarily reflects lower restructuring and branch transformation costs, and a significantly lower remediation charge relating to the treatment of some customers in arrears.

Review of business performance (continued)

Doing what matters for society
With origins going back to the start of the savings bank movement in the nineteenth century, TSB has always been committed to its wider role in society and to help communities thrive. We also know customers have greater expectations from businesses now, and they want the brands they deal with to share their values.

Our responsible business strategy – the Do What Matters Plan – ensures that we continue to grow sustainably and do the right thing by our customers, our colleagues and the communities we serve. For TSB, this means setting the gold standard for consumer protection through our industry-leading Fraud Refund Guarantee, paying suppliers promptly, ensuring we have more women in senior roles, working towards stretching diversity goals, and getting on with the vital work to achieve operational net zero by 2030.

The Do What Matters Plan, is a long-term programme that aligns to TSB's purpose of Money confidence. For everyone. Every day. It focuses on doing what matters for customers; small businesses; colleagues; communities; and the environment. Each pillar of the programme is sponsored by a member of the Executive Committee, and its key goals are to:

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

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

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

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

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

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

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

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

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

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

We will continue our journey to meet more of our customers' financial needs with comprehensive digital services and products combined with a personal touch through our contact centres, branches and with new video consultations.

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.

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

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

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

Component	Description	Financial statements	Key performance indicator
Customer confidence	We seek to deliver a banking experience that is the primary reason for customers to choose and remain with TSB, and which will increasingly set TSB apart from other banks and providers of financial services. Central to this is our purpose Money Confidence. For everyone. Every day. which focuses investment in digital capabilities and customer-led service strategies.	n/a	**Customer advocacy (Net Promoter Score)** **2021** / **2020** **2** / (4) **Total digitally active customers** **2021** / **2020** **67.8%** / 66.4%
Sources of funding and capital	Money deposited by customers into their personal current accounts (PCA) and savings accounts provides the majority of the funds we use to support lending to customers. We also raise funds from other sources, including wholesale markets and central banks, that diversify our funding profile. Our shareholder provides funding in the form of debt and equity capital.	Page 30	**Share of personal bank account gross flow** **2021** / **2020** **4.6%** / 4.5% **Share of PCA stock** **2021** / **2020** **4.2%** / 4.3%
Loans and liquid assets	Funds deposited with TSB are used to support lending to customers who wish to borrow. A portion of funds are held in reserve, in the form of a liquidity portfolio, to meet any unexpected funding requirements.	Page 34	**Mortgages gross lending (£m)** **2021** / **2020** **9.160.4** / 6,096.6
Income	We earn income in the form of interest that we receive on the loans we make to customers and from our liquidity portfolio. We pay interest to savings and bank account customers on the money they deposit with us. We also earn other income in the form of fees and charges for the provision of other banking services and commissions from the sale of certain products such as general insurance.	Page 44	**Net interest margin** **2021** / **2020** **2.44%** / 2.47%
Charges	The costs of running the Bank include paying our TSB employees, running our branches, investing in our business (such as developing digital opportunities) and paying for marketing. Occasionally, our customers are unable to repay the money they borrow from us; this is also a cost to the Bank in the form of an impairment charge. Finally, TSB complies with its tax obligations to Her Majesty's Revenue and Customs (HMRC).	Page 46	**Cost:income ratio (statutory basis)** **2021** / **2020** **84.2%** / 103.9% **Asset quality ratio** **2021** / **2020** **0.00%** / 0.51%

Risk management (financial statements on page 51)
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 the level of achievement of TSB's Primary Corporate Objectives, which includes delivery of the Do What Matters Plan, monitoring performance against risk appetite and reviewing customer management information that measures the execution of customer conduct strategies. These metrics, together with a wider dashboard of management information, are reviewed and discussed. In addition, the Remuneration Committee reviews achievement against the Primary Corporate Objectives at each meeting to support its decision making on variable remuneration outcomes. In this way, variable remuneration outcomes are directly linked to metrics that support the delivery of TSB's strategic objectives.

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

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

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

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

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

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

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

Strategic report (continued)

Section 172 statement (continued)

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

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.

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

TSB's Do What Matters Plan formalises the Bank's commitment to reducing its impact on the environment while helping customers and employees do the same. As part of this plan, we have committed to reduce our environmental impact and deliver against our goals as outlined in the Directors' report on pages 20 and 21. In addition, the Board has engaged with the climate change agenda throughout 2021, inputting into management's plans to recognise and mitigate the risks to the business arising from climate change. The majority of this engagement has taken place through regular discussion of the topic at Risk Committee meetings, and was complemented with a Board education session that was jointly hosted by TSB and EY. This session was designed to update on the consolidated activity at TSB regarding climate change risk, together with the regulatory context and requirements, and the progress being made by TSB in its risk management response to these. Further commentary on climate change risk is included in the Principal risks and uncertainties section starting on page 15. In addition to the five pillars considered by the Board and addressed through the Do What Matters Plan, the Board also has regard for the interests of the bank's shareholder and regulators as outlined below.

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

Other non-financial disclosures
TSB has a moral, legal and regulatory duty to prevent, detect and deter financial crime and maintains a financial crime framework. This framework is supported and reinforced by TSB systems and behaviours which put the customer at the heart of every interaction. TSB promotes an environment which is hostile to illicit activity to protect its customers, employees, and communities from financial crime, and continues to invest in further system control enhancements. TSB's compliance with requirements of the financial crime framework is monitored through ongoing control testing, assurance, audit, and the provision of management information at senior governance committees.

TSB's Modern Slavery Statement (which is available on our website) sets out the policies we apply and actions we take to ensure that our employees and customers are treated with dignity and respect. This includes raising awareness of issues that could put our customers at risk such as vulnerability and exploitation. The statement also explains how we ensure that TSB's values are applied within our supply chain, including the due diligence we carry out on our suppliers.

Strategic report (continued)

Review of financial performance

The Bank's performance is presented on a statutory basis, as explained under the basis of preparation on page 24, and structured in a manner consistent with the key elements of the Bank's business model as explained on page 5.

Income statement	**2021 £ million**	**2020 £ million**
Net interest income	**868.9**	786.4
Other income	**114.0**	146.5
Total income	**982.9**	932.9
Operating expenses	**(827.3)**	(969.4)
Impairment	**(0.1)**	(164.0)
Statutory profit/(loss) before taxation	**155.5**	(200.5)
Taxation	**(27.1)**	44.3
Statutory profit/(loss) for the year	**128.4**	(156.2)

TSB's statutory profit before tax for 2021 was £155.5 million compared to a loss before tax of £200.5 million in 2020. The key factors driving the notable year-on-year improvement were:

- *Income*: an increase in total income of 5.4% to £982.9 million (2020: £932.9 million), primarily reflecting growth in core mortgage balances in a buoyant housing market which was facilitated, in part, by lower stamp duty rates in the year and higher current account net other income from increased consumer spending. This was partially offset by lower interest-bearing credit card balances due to changes in consumer behaviour, lower gains on the sale of debt securities which reflects lower sales volumes, and lower migration related income from lower insurance recoveries and the prior period benefitting from dowry income from Lloyds Banking Group.

- *Operating expenses*: a reduction in operating expenses of 14.7% to £827.3 million (2020: £969.4 million) reflects lower levels of restructuring charges compared with 2020 due to a reduction in branch closure activity, lower severance and transformation costs, and a significantly lower remediation charge relating to the treatment of some customers in arrears, following the recognition of a £55.0 million provision in 2020.

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

Income

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

Other income decreased by 18.5% to £114.0 million, primarily due to lower migration related income. The prior period included £17.6 million of dowry income from Lloyds Banking Group. Excluding this, migration related income from insurance recoveries of post migration losses decreased to £10.3 million (2020: £17.5 million).

Operating expenses

Operating expenses decreased by 14.7% to £827.3 million, primarily driven by lower restructuring costs and lower conduct charges (a £55.0 million provision was recognised in 2020 for estimated charges relating to the treatment of some customers in arrears). In addition, ongoing progress on initiatives to improve the efficiency of the Bank, including the simplification of the Bank's organisational design and the branch transformation programme, led to a 3.7% reduction in the cost base reported on a management basis. Also supporting this reduction was a lower level of investment spend which was elevated in 2020 as TSB enhanced its digital capability in response to changing customer behaviours.

	2021 £ million	**2020 £ million**
Management basis operating expenses	**797.2**	827.7
Costs of restructuring the Bank	**26.5**	89.1
Collection and recovery conduct charges	**2.2**	55.0
Migration related items	**0.6**	1.0
Banking volatility	**0.8**	(3.4)
Statutory basis operating expenses	**827.3**	969.4

Impairment charge

The impairment charge decreased by 99.9% to £0.1 million, largely as a result of an improved economic outlook, including lower forecast unemployment and higher expected house prices. A summary of the economic scenarios used for assessing expected credit losses and related scenario weightings is provided in note 8 on pages 38 to 40.

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 and capital ratios remaining broadly stable and TSB maintaining liquid assets in excess of regulatory requirements and internal risk limits.

	2021 £ million	2020 £ million
Customer deposits	**35,951.9**	34,375.3
Non-customer funding	**7,992.5**	5,156.3
Borrowings from the Bank of England	**5,501.6**	3,065.8
Debt securities in issue	**2,199.1**	1,699.2
Subordinated liabilities	**291.8**	391.3
Shareholder's equity	**1,866.4**	1,724.9
Sources of funding	**45,810.8**	41,256.5
Other liabilities	**894.8**	1,165.9
Total equity and liabilities	**46,705.6**	42,422.4
Loans and advances to customers	**37,383.8**	33,317.9
Liquid asset portfolio(1)	**7,927.2**	7,530.7
Loans and liquid assets	**45,311.0**	40,848.6
Other assets	**1,394.6**	1,573.8
Total assets	**46,705.6**	42,422.4

(1) Comprises balances at central banks of £4,741.5 million (2020: £4,910.1 million) and debt securities of £3,185.7 million (2020: £2,620.6 million). Balances at central banks are combined with cash balances and on demand deposits of £109.6 million (2020: £146.2 million) when shown on the balance sheet on page 26.

Source of funding

- *Customer deposits.* Customer deposits increased by £1.6 billion, or 4.6%, to £36.0 billion, reflecting a slower rate of growth compared to 2020 as levels of customer spending increased following an easing of COVID-19 lockdown restrictions. Retail customer deposits grew by £1.3 billion to £33.2 billion, particularly in current account balances. Business banking customer deposit balances also saw growth with an increase of £0.3 billion, or 12.3%, to £2.8 billion. This was due to the flow of customers from the Incentivised Switching Scheme and business customers continuing to maintain higher levels of liquidity, supported by funds received through the Bounce Back Loan Scheme.

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

- *Capital resources*. TSB's capital position has remained above regulatory minimum requirements and internal risk appetite thresholds, with a Common Equity Tier 1 (CET1) capital ratio of 15.9% (2020: 14.9%) and a leverage ratio of 3.6% (2020: 3.7%) on a CRD IV fully loaded basis. In 2021, the increase in the CET1 capital ratio reflected the increase in retained profit while credit risk-weighted assets remained stable.

Loans and liquid assets

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

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

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. Risks faced by TSB in delivering its business strategy are managed in the context of the wider communities in which TSB operates and the Do What Matters Plan. TSB's approach to managing these risks is described below.

Risk management framework

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

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

Accountability

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

First line of defence	• Identifies and manages risks in line with prescribed TSB risk management standards. • 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 profile 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.

Risk culture

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

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

Strategic report (continued)

Principal risks and uncertainties (continued)

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

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

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

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

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

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

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

Strategic report (continued)

Principal risks and uncertainties (continued)

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

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

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

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

Strategic report (continued)

Principal risks and uncertainties (continued)

Principal risks and uncertainties faced by TSB (continued)

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

Strategic report (continued)

Principal risks and uncertainties (continued)

Principal risks and uncertainties faced by TSB (continued)

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

Emerging risks

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

- *Post COVID-19 related risks*

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

- *Risk of long period of high inflation*

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

- *Post Brexit regulatory and political impacts*

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

Strategic report (continued)

Principal risks and uncertainties (continued)

- *Climate Change*

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

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

Governance

The Board provides strategic direction on both the Bank's climate change approach and its fit within the Do What Matters Plan using the regular updates and mechanisms described below. The Chief Risk Officer and Chief Financial Officer have responsibility for TSB's approach to managing the financial risks from climate change, including the embedding of climate change risks within the existing risk management framework, development of scenario analysis, embedding climate change within governance and complying with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The Risk Committees, as referenced in the Risk Governance section (page 11), maintain a forward-looking view of TSB's risk profile taking into account the financial risks from climate change.

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

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

Risk Management

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

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

Strategy, risks and opportunities

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

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

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

Strategic report (continued)

Principal risks and uncertainties (continued)

Climate change risk (continued)

Strategic initiatives
In January 2021, TSB published its pathway to reach operational net-zero carbon emissions by 2030, a key commitment in our responsible business strategy, the 'Do What Matters Plan'. As a member of the United Nation's Net Zero Banking Alliance, TSB has committed to aligning its lending portfolio with net-zero emissions by 2050. TSB will deliver a net-zero carbon pathway that meets international standards that is independently validated by the Science Based Targets Initiative. This is supported by TSB's membership of the Partnership for Carbon Accounting Financials. Details of our pathway to further reduce the carbon emissions from our own operations, are outlined on pages 20 and 21.

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

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

As reflected above, TSB has developed a pragmatic environmental strategy as part of the Do What Matters Plan. It is structured around the following four key priorities:

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

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

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

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

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

Strategic report (continued)

Principal risks and uncertainties (continued)

Climate change risk (continued)

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

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

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

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

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

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

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

See pages 20 and 21 for details of our energy, carbon and emissions reporting.

Strategic report on pages 3 to 17 approved, by order of the Board

Keith Hawkins
Company Secretary,
26 January 2022

Directors' report

Introduction

The Directors of TSB Bank plc (the 'Company') present their report and audited financial statements for the year ended 31 December 2021, in accordance with section 415 of the Companies Act 2006. The information in the section 172 statement (pages 6 and 7) on employee engagement and fostering of business relationships with customers, suppliers and others 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 17.

Dividends

The Directors do not currently propose to pay a 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 2021, the indemnities were in place throughout 2021. The indemnity for Adam Banks was executed on 8 February 2021, for Alicia Reyes on 18 May 2021, for Declan Hourican on 14 September 2021, and for Nick Prettejohn on 1 November 2021. The indemnity for Robin Bulloch was executed on 14 January 2022. Each of the indemnities remain in force at the date of signing these financial statements and are available for inspection at the Company's registered office.

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 33 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 5.

Employee information

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

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

Diversity of our workforce

During 2021 significant progress has been made to achieve a truly diverse workforce that reflects the UK working age population by 2025. The number of senior roles held by women increased to 41% (2020: 39%), above the industry average of 34%. Asian and Minority Ethnic representation in senior roles also increased, with overall Black, Asian and Minority Ethnic representation reaching 9% (2020: 7%). However, we recognise that the increase in Black representation was slower, and consequently, a targeted Black talent plan is now in place to drive progress in 2022.

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

Directors’ report (continued)

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

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

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

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

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

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

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

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

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

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

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

Directors' report (continued)

Environmental information

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

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

In January 2021, we committed to achieve net zero emissions from our own operations (Scope 1 and 2 greenhouse gas emissions) by 2030, alongside signing up to the Science Based Targets initiative, which requires us to set credible absolute and net zero targets by the end of 2022. This year TSB also joined the Net-Zero Banking Alliance (NZBA), an industry-led, UN-convened alliance of banks worldwide, committed to aligning their lending and investment portfolios with the goals of the UN Paris Agreement by 2050, or sooner.

Our operational emissions arise from heating and cooling the TSB property estate and from company cars (Scope 1), and electricity consumption (Scope 2). Scope 3 emissions that are reported relate to TSB's business travel, waste, water and paper usage. We have conducted initial analysis of other Scope 3 categories including purchased goods and services, and mortgages which we will further refine in 2022. In 2021, TSB joined the Partnership for Carbon Accounting Financials (PCAF) UK to support analysis of Scope 3 emissions from the mortgage portfolio and, as members, are engaged with the PCAF UK Residential Mortgages Working Group.

Summary of Streamlined Energy and Carbon Reporting (SECR)

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

Summary of Streamlined Energy and Carbon Reporting	**2021**	**2020**	**2019**
Emissions – Location-based [1] in gross tonnes of carbon dioxide equivalent (tCO_2e[2])			
Scope 1 emissions from the combustion of fuel and operation of facilities [3]	**2,171**	2,761	3,010
Scope 2 emissions from the purchase of electricity [4]	**4,267**	5,561	7,139
Total scope 1 and 2 location-based emissions	**6,438**	8,322	10,149
Scope 3 emissions from business travel, waste, water and paper	**745**	1,509	3,330
Total Scope 1, 2 and 3 location-based emissions	**7,183**	9,831	13,479
Intensity ratio [5]	**1.2**	1.4	1.7
Energy consumption kWh (million) [6]	**31.378**	39.310	43.720

(1) Location-based emissions are those measured using the UK national grid electricity conversion factors, updated annually.
(2) tCO_2e – tonnes of carbon dioxide equivalent.
(3) Scope 1 emissions: gas, heating oil, fugitive gas, and company cars.
(4) Scope 2 emissions: direct commercial electricity supplies plus landlord data where available.
(5) Calculated as the sum of Scope 1, 2 and 3 location-based emissions divided by the average annual headcount.
(6) Scope 1, 3, and energy consumption totals include both mandatory and voluntary elements of SECR reporting.

Directors’ report (continued)

Environmental information (continued)

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

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

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

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

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

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

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

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

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

Directors' report (continued)

Political donations and expenditure
No amounts were given for political purposes during the year.

Financial instruments
Information on financial risk management objectives and policies in relation to the use of financial instruments can be found starting on page 51 of the financial statements.

Principal risks and uncertainties
The principal risks and uncertainties faced by the Company are set out starting on page 12.

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

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

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

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 24, 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 51 of the annual report and accounts of the Company's parent, TSB Banking Group plc, under the heading 'viability statement.'

Directors’ report (continued)

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.

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

K. H

Keith Hawkins
Company Secretary,
26 January 2022

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 74. These consolidated financial statements have been prepared in accordance with UK adopted international accounting standards.

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

Going concern
The going concern basis is dependent on maintaining enough capital and funding of the balance sheet. The Directors considered a number of factors including the forecasts for TSB and its capital and liquidity position. TSB's business activities and objectives, together with the factors likely to affect its future development, performance and position are set out in the Strategic report. In 2021, TSB reported a profit before tax for the year of £155.5 million (2020: £200.5 million loss before tax) and continues to be in compliance with, and exceeds, its regulatory capital and liquidity requirements.

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

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

Consolidation - Subsidiaries are all entities (including special purpose entities) over which 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 consolidated financial statements

The Bank's primary consolidated financial statements are presented on pages 26 to 79. The notes to these consolidated financial statements are structured to follow the Bank's business model as set out on page 5 and are listed below.

Balance sheets

as at 31 December 2021

	Note	Bank (Consolidated) 2021 £ million	Bank (Consolidated) 2020 £ million	Company 2021 £ million	Company 2020 £ million
Assets					
Financial assets at amortised cost:					
Cash, cash balances at central banks and other demand deposits		**4,851.1**	5,056.3	**4,851.1**	5,056.3
Debt securities	6	**2,166.7**	1,123.7	**2,166.7**	1,123.7
Loans and advances to customers	8	**37,383.8**	33,317.9	**37,383.8**	33,317.9
Loans and advances to central banks and credit institutions	7	**199.7**	164.2	**143.6**	120.9
Other advances	9	**80.7**	217.5	**80.7**	217.5
Financial assets at fair value through other comprehensive income					
Debt securities	6	**1,069.0**	1,496.9	**1,069.0**	1,496.9
Financial assets at fair value through profit or loss					
Derivative financial assets not in hedge accounting relationships	21	**168.4**	198.3	**168.4**	198.3
Hedging derivative financial assets	21	**244.5**	139.9	**244.5**	139.9
Fair value adjustments for portfolio hedged risk	21	**(109.3)**	80.2	**(109.3)**	80.2
Property and equipment	25	**300.3**	258.9	**300.3**	258.9
Intangible assets	27	**72.1**	49.5	**72.1**	49.5
Deferred tax assets	17	**122.6**	144.5	**122.6**	144.5
Other assets	28	**156.0**	174.6	**212.1**	217.8
Total assets		**46,705.6**	42,422.4	**46,705.6**	42,422.3
Liabilities					
Financial liabilities at amortised cost:					
Customer deposits	1	**35,951.9**	34,375.3	**35,951.9**	34,375.3
Borrowings from central banks	2	**5,501.6**	3,065.8	**5,501.6**	3,065.8
Debt securities in issue	2	**2,199.1**	1,699.2	**2,199.1**	1,699.2
Subordinated liabilities	3	**291.8**	391.3	**291.8**	391.3
Lease liabilities	26	**163.5**	123.3	**163.5**	123.3
Other financial liabilities	4	**193.6**	51.6	**193.6**	51.6
Financial liabilities at fair value through profit or loss:					
Derivative financial liabilities not in hedge accounting relationships	21	**156.5**	299.7	**156.5**	299.7
Hedging derivative financial liabilities	21	**136.8**	225.2	**136.8**	225.2
Fair value adjustments for portfolio hedged risk	21	**(63.6)**	117.0	**(63.6)**	117.0
Provisions	29	**110.2**	153.1	**110.2**	153.1
Other liabilities	30	**197.8**	196.0	**197.8**	195.9
Total liabilities		**44,839.2**	40,697.5	**44,839.2**	40,697.4
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 brought forward	22	**1,045.7**	1,201.9	**1,045.7**	1,212.6
Profit/(loss) attributable to the shareholder for the current year	22	**128.4**	(156.2)	**128.4**	(166.9)
Fair value reserve	22	**11.1**	11.6	**11.1**	11.6
Cash flow hedging reserve	22	**(6.6)**	(20.2)	**(6.6)**	(20.2)
Shareholder's equity		**1,866.4**	1,724.9	**1,866.4**	1,724.9
Total equity and liabilities		**46,705.6**	42,422.4	**46,705.6**	42,422.3

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 26 to 79 were approved by the Board of Directors on 26 January 2022 and signed on its behalf by:

Robin Bulloch
Interim Chief Executive

Declan Hourican
Chief Financial Officer

Consolidated statement of comprehensive income

for the year ended 31 December 2021

Income statement:	Note	Bank 2021 £ million	Bank 2020 £ million
Interest and similar income:			
Interest income calculated using the effective interest method	11	**946.4**	922.0
Other interest income	11	**(35.0)**	(41.0)
Total interest and similar income		**911.4**	881.0
Interest and similar expense	11	**(42.5)**	(94.6)
Net interest income	11	**868.9**	786.4
Fee and commission income (1)	12	**121.8**	104.6
Fee and commission expense (1)	12	**(18.2)**	(18.7)
Net fee and commission income	12	**103.6**	85.9
Net gains/(losses) on financial assets and liabilities:			
Gains on derecognition of financial assets measured at fair value through other comprehensive income		**7.0**	21.8
Losses on derivative financial assets at fair value through profit or loss		**(2.5)**	(1.3)
(Losses)/gains from hedge accounting	21	**(2.4)**	5.8
Losses on derecognition of non-financial assets		**(2.6)**	(3.5)
Other operating income	13	**10.9**	37.8
Other income		**114.0**	146.5
Total income		**982.9**	932.9
Total operating expenses	14	**(827.3)**	(969.4)
Operating profit/(loss) before impairment losses and taxation		**155.6**	(36.5)
Impairment losses on financial assets at amortised cost	18	**(2.6)**	(162.7)
Impairment credit/(losses) on loan commitments	29	**2.5**	(1.3)
Total impairment losses		**(0.1)**	(164.0)
Profit/(loss) before taxation		**155.5**	(200.5)
Taxation	16	**(27.1)**	44.3
Profit/(loss) for the year	22	**128.4**	(156.2)
Other comprehensive income/(loss):			
Items that may be subsequently reclassified to profit or loss:			
Change in fair value reserve:			
Change in fair value	21	**6.2**	14.8
Transfers to the income statement	21	**(7.0)**	(17.0)
Taxation thereon	17	**0.3**	0.2
	22	**(0.5)**	(2.0)
Change in cash flow hedging reserve:			
Change in the fair value of derivatives in cash flow hedges	21	**24.0**	(21.5)
Transfers to the income statement	21	**(5.4)**	(2.9)
Taxation thereon	17	**(5.0)**	6.7
	22	**13.6**	(17.7)
Other comprehensive income/(loss) for the year, net of taxation		**13.1**	(19.7)
Total comprehensive income/(loss) for the year		**141.5**	(175.9)

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

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

Statements of changes in equity

for the year ended 31 December 2021

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 2020	79.4	195.6	412.8	13.6	(2.5)	1,201.9	1,900.8
Comprehensive loss:							
Loss for the year	–	–	–	–	–	(156.2)	(156.2)
Other comprehensive loss	–	–	–	(2.0)	(17.7)	–	(19.7)
Total comprehensive loss	–	–	–	(2.0)	(17.7)	(156.2)	(175.9)
Balance at 31 December 2020	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 income/(loss)	**–**	**–**	**–**	**(0.5)**	**13.6**	**–**	**13.1**
Total comprehensive 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**

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 2020	79.4	195.6	412.8	13.6	(2.3)	1,212.6	1,911.7
Comprehensive loss:							
Loss for the year	–	–	–	–	–	(166.9)	(166.9)
Other comprehensive loss	–	–	–	(2.0)	(17.9)	–	(19.9)
Total comprehensive loss	–	–	–	(2.0)	(17.9)	(166.9)	(186.8)
Balance at 31 December 2020	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 income/(loss)	**–**	**–**	**–**	**(0.5)**	**13.6**	**–**	**13.1**
Total comprehensive 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**

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

Cash flow statements

for the year ended 31 December 2021

	Note	Bank (Consolidated) 2021 £ million	Bank (consolidated) 2020 £ million	Company 2021 £ million	Company 2020 £ million
Cash flows from operating activities					
Profit/(loss) before taxation		**155.5**	(200.5)	**155.5**	(215.2)
Adjustments for:					
Change in operating assets and liabilities	31	**(2,404.5)**	2,255.6	**(2,404.5)**	1,897.0
Non-cash and other items	31	**112.0**	279.5	**112.0**	222.3
Taxation paid		**(8.7)**	–	**(8.7)**	–
Net cash (used in)/provided by operating activities		**(2,145.7)**	2,334.6	**(2,145.7)**	1,904.1
Cash flows from investing activities					
Purchase of property and equipment		**(44.5)**	(30.2)	**(44.5)**	(30.2)
Purchase and development of intangible assets		**(30.3)**	(35.9)	**(30.3)**	(35.9)
Purchase of debt securities		**(1,324.5)**	(1,341.3)	**(1,324.5)**	(1,341.3)
Sale of debt securities		**500.9**	977.8	**500.9**	977.8
Proceeds from maturing investments		**23.0**		**23.0**	-
Interest received on debt securities		**36.3**	38.8	**36.3**	38.8
Net cash used in investing activities		**(839.1)**	(390.8)	**(839.1)**	(390.8)
Cash flows from financing activities					
Additional borrowings from central banks		**5,500.0**	–	**5,500.0**	–
Repayment of borrowing from central banks		**(3,065.0)**	(1,410.0)	**(3,065.0)**	(1,410.0)
Interest paid on borrowings from central banks		**(7.8)**	(17.2)	**(7.8)**	(17.2)
Issue of debt securities in issue		**500.0**	450.0	**500.0**	450.0
Interest paid on debt securities in issue		**(21.0)**	(14.4)	**(21.0)**	(14.4)
Issue of subordinated liabilities		**300.0**	–	**300.0**	–
Repayment of subordinated liabilities		**(385.0)**	(440.2)	**(385.0)**	–
Interest paid on subordinated liabilities		**(18.8)**	(22.1)	**(18.8)**	(22.1)
Net securitisation funding		**–**	–	**–**	(9.7)
Lease payments		**(22.8)**	(26.4)	**(22.8)**	(26.4)
Net cash provided by/(used in) financing activities		**2,779.6**	(1,480.3)	**2,779.6**	(1,049.8)
Change in cash and cash equivalents		**(205.2)**	463.5	**(205.2)**	463.5
Cash and cash equivalents at 1 January	31	**5,056.3**	4,592.8	**5,056.3**	4,592.8
Cash and cash equivalents at 31 December	31	**4,851.1**	5,056.3	**4,851.1**	5,056.3

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

2. Wholesale funding

(i) Debt securities in issue

The following table shows debt securities in issue:

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

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

Notes to the financial statements

Sources of funding (continued)

2. Wholesale funding (continued)

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

Company	Balance at 1 Jan 2020 £ million	Issues/ (Repayments) £ million	Exchange rate and other adjustments £ million	Balance at 31 Dec 2020 £ million
Series 2017-1 Covered Bonds	498.9	–	0.1	499.0
Series 2019-1 Covered Bonds	750.9	–	(0.8)	750.1
Senior unsecured debt securities	–	450.0	0.1	450.1
Total debt securities in issue	1,249.8	450.0	(0.6)	1,699.2

Covered bond programmes

Loans and advances to customers of £2,563.5 million (2020: £1,815.0 million) have been assigned to a limited liability partnership to provide security for the issuance of covered bonds of £1,749.1million (2020: £1,249.1 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 £56.1 million (2020: £43.3 million) held by the partnership are restricted in use to repayment of the term advances related to covered bonds and other legal obligations (note 7 on page 37). At 31 December 2021, 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 2021 or 2020. During 2021 and 2020, there were no defaults on any principal or interest or any other breaches with respect to borrowings under the covered bond programmes.

Senior unsecured debt securities in issue

In December 2020, the Company issued £450.0 million floating rate notes, due to mature in June 2023, 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 2.1% payable quarterly in arrears. The Company has the option to redeem these notes in June 2022 and quarterly thereafter, subject to approval of the PRA.

(ii) Borrowings from central banks

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

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

Notes to the financial statements

Sources of funding (continued)

3. Subordinated liabilities

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

In March 2021, the Company issued £300.0 million fixed-to-floating rate callable subordinated Tier 2 capital notes, due to mature in March 2031, to its parent company, 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 2031 at which time the interest rate becomes SONIA plus 3.05% per annum payable quarterly in arrears. The Company has the option to redeem these notes in March 2026, subject to approval of the PRA.

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

4. Other financial liabilities

	Bank 2021 £ million	Bank 2020 £ million	Company 2021 £ million	Company 2020 £ million
Items in the course of transmission to credit institutions	**44.0**	41.7	**44.0**	41.7
Items in the course of transmission to non-credit institutions	**4.6**	7.3	**4.6**	7.3
Collateral placed at central clearing houses	**143.6**	2.6	**143.6**	2.6
Collateral placed with credit institutions	**1.4**	–	**1.4**	–
Total other financial liabilities	**193.6**	51.6	**193.6**	51.6

5. Fair value of financial liabilities

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

Bank and Company	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2021					
Customer deposits	**–**	**35,952.4**	**–**	**35,952.4**	**35,951.9**
Debt securities in issue	**1,762.5**	**451.9**	**–**	**2,214.4**	**2,199.1**
Subordinated liabilities	**–**	**299.8**	**–**	**299.8**	**291.8**
Derivative liabilities at fair value through profit or loss	**–**	**156.5**	**–**	**156.5**	**156.5**
Hedging derivative liabilities	**–**	**136.8**	**–**	**136.8**	**136.8**
At 31 December 2020					
Customer deposits	–	34,405.2	–	34,405.2	34,375.3
Debt securities in issue	1,267.1	450.1	–	1,717.2	1,699.2
Subordinated liabilities	–	394.0	–	394.0	391.3
Derivative liabilities at fair value through profit or loss	–	299.7	–	299.7	299.7
Hedging derivative liabilities	–	225.2	–	225.2	225.2

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

Notes to the financial statements

Sources of Funding (continued)

5. Fair value of financial liabilities (continued)

The fair value of customer deposits repayable on demand is considered to be equal to their carrying value given they are short term in nature. The fair value for all other customer deposits is estimated using discounted cash flows applying either market rates, where applicable, or current rates for deposits of similar remaining maturities. 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, deposits from credit institutions, and other financial liabilities is a reasonable approximation of fair value as these balances are either on demand or variable rate and as such these amounts are considered as Level 2.

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

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

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 effective for the year ended December 2021

(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), and other advances. A financial asset is recognised on the balance sheet when the cash is advanced to the borrower, or in the case of purchases of debt securities, on the settlement date.

Classification and measurement

On initial recognition, financial assets are classified into one of three measurement categories, amortised cost, fair value through other comprehensive income, or fair value through profit or loss depending on 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.

Loans and liquid assets (continued)

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

(c) Impairment of financial assets

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

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

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

Definition of default for IFRS 9

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

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

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

Significant increase in credit risk

Financial assets are considered to be in stage 2 when their credit risk has increased significantly since initial recognition. The main factor that is considered by 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 a factor of 2 times the origination PD and the increase is between 10bps and 410bps (for different cohorts of secured retail), between 250bps and 770bps for unsecured products, and more than 50bps for business banking assets. As a secondary qualitative assessment criterion, financial assets that are in forbearance but not credit impaired are considered to have experienced significant increase in credit risk and will be in stage 2. As a backstop, the presumption that all financial assets that are more than 30 days past due have experienced a significant increase in credit risk is not rebutted. Consequently, in respect of loans and advances to customers, The Bank 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 low credit risk exemption is used and these financial assets are categorised as stage 1.

Credit Impaired (stage 3)

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

Notes to the financial statements

Loans and liquid assets (continued)

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

(c) Impairment of financial assets (continued)

Purchased or originated credit impaired (POCI)

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

Write offs

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

Modified financial assets and derecognition

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

Methodology for measuring expected credit losses

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

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

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

(d) Derecognition of financial assets

Financial assets are derecognised when the contractual right to receive cash flows from those assets has expired or when 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)	**2021 £ million**	**2020 £ million**
UK Gilts	**1,069.0**	1,405.4
Supranational and development bank bonds	**–**	91.5
Total debt securities at FVOCI	**1,069.0**	1,496.9

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

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

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

At 31 December 2020, UK gilts at FVOCI with a carrying value of £225.8 million were subject to repurchase agreements. No such amounts were present at December 2021. In addition, £257.5 million of debt securities at amortised cost had been pledged as collateral (2020: £190.1 million).

7. Loans and advances to central banks and credit institutions

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

Company	**2021 £ million**	**2020 £ million**
Loans and advances to central banks	**143.6**	120.9
Total	**143.6**	120.9

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

Notes to the consolidated financial statements

Loans and liquid assets (continued)

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

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

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

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

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

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

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

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

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

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

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

Notes to the consolidated financial statements

Loans and liquid assets (continued)

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

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

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

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

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

Upside: A benign reflation

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

Downside scenario: Renewed pandemic headwinds

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

Severe downside (low interest rate) scenario: Uncontrolled pandemic

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

Severe downside (high interest rate) scenario: Prolonged stagflation

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

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

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

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

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

Notes to the consolidated financial statements

Loans and liquid assets (continued)

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

Forward looking economic scenarios (continued)

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

							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	**30%**	GDP	**1.3 %**	**2.4 %**	**1.2 %**	**1.2 %**	**1.2 %**
		Unemployment	**6.7 %**	**5.6 %**	**4.7 %**	**4.5 %**	**4.5 %**
		House prices	**(14.3)%**	**0.8 %**	**10.9 %**	**5.0 %**	**4.2 %**
		Interest rates	**0.1 %**	**0.1 %**	**0.1 %**	**0.1 %**	**0.25 %**
Severe downside (Low rate)	**5%**	GDP	**(0.4)%**	**10.0 %**	**4.3 %**	**2.1 %**	**1.5 %**
		Unemployment	**11.9 %**	**10.0 %**	**6.6 %**	**5.0 %**	**4.8 %**
		House prices	**(25.9)%**	**(1.3)%**	**22.3 %**	**7.9 %**	**6.0 %**
		Interest rates	**(0.1)%**	**(0.1)%**	**(0.1)%**	**0 %**	**0.1 %**
Severe downside (High rate)	**5%**	GDP	**(1.4)%**	**0 %**	**1.3 %**	**1.4 %**	**1.4 %**
		Unemployment	**10.3 %**	**11.2 %**	**10.2 %**	**9.1 %**	**8.1 %**
		House prices	**(25.9)%**	**(12.6)%**	**8.6 %**	**10.0 %**	**10.0 %**
		Interest rates	**3.25 %**	**3.25 %**	**3.0 %**	**2.5 %**	**2.0 %**
Weighted average	**n/a**	GDP	**3.3 %**	**2.3 %**	**1.5 %**	**1.4 %**	**1.4 %**
		Unemployment	**5.9 %**	**5.1 %**	**4.6 %**	**4.4 %**	**4.3 %**
		House prices	**(8.0)%**	**1.2 %**	**6.3 %**	**3.9 %**	**3.6 %**
		Interest rates	**0.5 %**	**0.7 %**	**0.7 %**	**0.7 %**	**0.8 %**

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

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

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

Notes to the consolidated 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

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

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

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

Judgements required in assessing post model adjustments

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

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

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

COVID-19 related (consumer behaviour)

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

Notes to the consolidated financial statements

Loans and liquid assets (continued)

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

Judgements required in assessing post model adjustments (continued)

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

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

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

Economic scenarios
- The economic scenarios PMA in 2020 reflected late changes in economic scenarios that took account of Brexit negotiations and COVID-19.

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

Judgements required in assessing significant increase in credit risk
TSB's policy for determining when a financial asset has experienced a significant increase in credit risk is explained on page 35. In applying this policy, the key judgement is the level of increase in the residual lifetime PD as compared to the equivalent position at the origination of the financial asset.

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

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

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

Notes to the financial statements

Loans and liquid assets (continued)

9. Other advances

	Bank 2021 £ million	Bank 2020 £ million	Company 2021 £ million	Company 2020 £ million
Items in the course of collection from credit institutions	**17.7**	21.7	**17.7**	21.7
Items in the course of collection from non-credit institutions	**12.9**	2.8	**12.9**	2.8
Collateral placed at central clearing houses	**21.5**	190.8	**21.5**	190.8
Collateral placed with credit institutions	**0.1**	2.2	**0.1**	2.2
Amounts due from the British Business Bank	**28.5**	–	**28.5**	–
Total other advances	**80.7**	217.5	**80.7**	217.5

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 of financial assets presented on the balance sheet and the fair value of these financial instruments. 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 and Company	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2021					
Debt securities at amortised cost	**2,164.1**	**30.0**	**–**	**2,194.1**	**2,166.7**
Loans and advances to customers	**–**	**–**	**37,644.1**	**37,644.1**	**37,383.8**
Financial assets at fair value through other comprehensive income	**1,069.0**	**–**	**–**	**1,069.0**	**1,069.0**
Derivative assets at fair value through profit or loss	**–**	**168.4**	**–**	**168.4**	**168.4**
Hedging derivative assets	**–**	**244.5**	**–**	**244.5**	**244.5**
At 31 December 2020					
Debt securities at amortised cost	1,127.9	–	–	1,127.9	1,123.7
Loans and advances to customers	–	–	33,315.0	33,315.0	33,317.9
Financial assets at fair value through other comprehensive income	1,496.9	–	–	1,496.9	1,496.9
Derivative assets at fair value through profit or loss	–	198.3	–	198.3	198.3
Hedging derivative assets	–	139.9	–	139.9	139.9

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

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.

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

Notes to the financial statements

Income

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

Accounting policies relevant to recognising income

(e) Interest income and expense

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

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

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by 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	2021 £ million	2020 £ million
Interest and similar income		
Interest income calculated using the effective interest method:		
Cash, cash balances at central banks and other demand deposits	**3.9**	9.8
Financial assets at fair value through other comprehensive income	**9.5**	15.1
Debt securities at amortised cost	**16.7**	7.6
Loans to credit institutions	**–**	0.5
Loans and advances to customers	**916.3**	889.0
	946.4	922.0
Derivative financial instruments	**(35.0)**	(41.0)
Total interest and similar income	**911.4**	881.0
Interest and similar expense		
Interest expense calculated using the effective interest method:		
Borrowings from central banks	**(8.6)**	(9.5)
Deposits from credit institutions	**(0.1)**	(0.1)
Customer deposits	**(29.2)**	(74.7)
Debt securities in issue	**(20.9)**	(13.8)
Subordinated liabilities	**(15.6)**	(22.4)
Lease liabilities	**(2.6)**	(1.3)
Provisions	**(0.9)**	–
	(77.9)	(121.8)
Derivative financial instruments	**35.4**	27.2
Total interest and similar expense	**(42.5)**	(94.6)
Net interest income	**868.9**	786.4

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

12. Net fee and commission income

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

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

13. Other operating income

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

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

Notes to the financial statements

Charges

Running a bank with 5 million customers comes with overheads. Charges we incur include the costs of paying our employees, running our branches, investing in our business, paying for advertising and marketing. Occasionally, our customers' circumstances change and they are expected to be unable to repay the money they borrow from us causing us to incur impairment losses. Finally, 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	2021 £ million	2020 £ million
Staff costs		
Wages and salaries	**238.6**	239.8
Social security costs	**26.3**	25.7
Other pension costs	**31.6**	32.1
Severance costs	**8.6**	45.1
Other staff costs	**7.2**	6.3
Total staff costs	**312.3**	349.0
Premises expenses		
Rent	**1.7**	7.3
Rates, maintenance and other premises expenses	**43.0**	63.4
Total premises expenses	**44.7**	70.7
Other expenses		
IT servicing and licence costs	**222.6**	231.7
Regulatory, legal and consultancy costs	**42.5**	58.9
Collection and recovery conduct charges	**2.2**	55.0
Marketing	**36.1**	42.3
Other expenses(1)	**96.7**	87.5
Total other expenses	**400.1**	475.4
Depreciation of property and equipment	**37.4**	41.8
Depreciation of right of use asset	**25.1**	25.8
Amortisation of intangible assets	**7.7**	6.7
Total operating expenses	**827.3**	969.4

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

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

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

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

Share based compensation

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

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

Notes to the financial statements

Charges (continued)

14. Operating expenses (continued)

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

	2021 £ million	2020 £ million
Fees payable to the Company's auditor for the audit of the Company's annual accounts (1)	**3.0**	2.6
Fees payable to the Company's auditor and its associates for other services:		
Audit related assurance services (2)	**1.5**	1.1
Other non audit services	**0.1**	–
Total fees payable to TSB's auditors	**4.6**	3.7

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

15. Directors' emoluments

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

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

The aggregate remuneration of the highest paid director was £1,075,903 (2020: £1,166,327) for qualifying services as a TSB director.

The table below presents the number of Directors, who:

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

16. Taxation

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

Bank	2021 £ million	2020 £ million
UK corporation tax		
Current tax		
Current tax charge on profit/(loss) for the year	**(9.9)**	–
Deferred tax (note 17)		
Origination and reversal of temporary differences:		
Deferred tax charge on business transfers	**(20.5)**	(20.5)
Change in UK corporation tax rate	**15.3**	7.7
Accelerated capital allowances	**1.2**	0.7
Adjustments in respect of prior years	**2.7**	1.7
Deferred tax (charge)/credit in relation to trading losses	**(13.3)**	57.3
Other	**(2.6)**	(2.6)
Deferred tax (charge)/credit	**(17.2)**	44.3
Taxation (charge)/credit	**(27.1)**	44.3

Notes to the financial statements

Charges (continued)

16. Taxation (continued)

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

Bank	2021 £ million	2020 £ million
Profit/(loss) before taxation	**155.5**	(200.5)
Taxation (charge)/credit at applied UK corporation tax rate of 27.0% (2020: 27.0%)	**(42.0)**	54.1
Factors affecting charge:		
Disallowed costs	**(5.1)**	(19.7)
Changes to UK corporation tax rates	**15.3**	7.7
Adjustments in respect of prior years	**2.7**	1.7
Taxable profits not subject to 8% bank surcharge	**2.0**	–
Other	**–**	0.5
Taxation (charge)/credit	**(27.1)**	44.3

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

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

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

17. Deferred tax assets

The movement in deferred tax assets is as follows:

	Bank 2021 £ million	Bank 2020 £ million	Company 2021 £ million	Company 2020 £ million
Opening balance	**144.5**	96.1	**144.5**	92.1
Income statement credit/(charge) (note 16)	**(17.2)**	44.3	**(17.2)**	48.3
Group relief	**–**	(2.8)	**–**	(2.8)
Amounts charged to equity:				
Movements in fair value reserve	**0.3**	0.2	**0.3**	0.2
Movements in cash flow hedge reserve	**(5.0)**	6.7	**(5.0)**	6.7
At 31 December	**122.6**	144.5	**122.6**	144.5

Deferred tax assets are comprised as follows:

	Bank 2021 £ million	Bank 2020 £ million	Company 2021 £ million	Company 2020 £ million
Deferred tax arising on carried forward trading losses	**98.9**	102.0	**98.9**	102.0
Deferred tax arising on business transfers	**–**	20.5	**–**	20.5
Deferred tax in respect of the transition to IFRS 9	**18.3**	18.2	**18.3**	18.2
Deferred tax arising on cash flow hedge reserve	**2.4**	7.4	**2.4**	7.4
Revaluations of financial assets at fair value through other comprehensive income	**(4.1)**	(4.4)	**(4.1)**	(4.4)
Other temporary differences	**7.1**	0.8	**7.1**	0.8
Total deferred tax assets	**122.6**	144.5	**122.6**	144.5

Notes to the financial statements

Charges (continued)

17. Deferred tax assets (continued)

Significant judgement

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

In October 2021, it was announced that the bank surcharge would be reduced from 8% to 3% with effect from 1 April 2023. This change will be reflected in the measurement of the deferred tax asset when it is substantively enacted, which is not currently expected until early 2022. The estimated impact on the deferred tax asset at 31 December 2021 had this change taken effect would have been to reduce the deferred tax asset by £12.8 million, with a corresponding deferred tax charge in the statement of comprehensive income.

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

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

Hedge accounting

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

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

Fair value hedges

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

Cash flow hedges

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

Notes to the 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:

Bank and Company	2021 Exposure £ million	2021 Credit Quality	2020 Exposure £ million	2020 Credit Quality
Loans and advances to customers	**37,383.8**	**Note 18(ii)**	33,317.9	Note 18(ii)
Other financial assets at amortised cost:				
Cash, cash balances at central banks and other demand deposits:				
Cash	**100.7**	**Not rated**	143.6	Not rated
Balances with central banks	**4,741.5**	**AA-**	4,910.1	AA-
On demand deposits	**8.9**	**At least BBB**	2.6	At least BBB
Debt securities at amortised cost(1)	**2,166.7**	**At least AA-**	1,123.7	At least AA-
Loans and advances to credit institutions(2)	**56.1**	**A+**	43.3	A+
Loans and advances to central banks	**143.6**	**AA-**	120.9	AA-
Government institutions	**28.6**	**AA-**		
Other advances	**52.1**	**Not rated**	217.5	At least BBB
Financial assets at fair value through other comprehensive income	**1,069.0**	**AA-**	1,496.9	At least AA-
Financial assets subject to expected credit loss requirements	**45,751.0**		41,376.5	
Derivative financial assets(3)	**412.9**		338.2	
Total on-balance sheet financial assets	**46,163.9**		41,714.7	
Lending commitments	**6,467.4**	**Note 18(ii)**	6,251.5	Note 18(ii)
Maximum credit risk exposure	**52,631.3**		47,966.2	

(1) Includes £472.8 million (2020: £482.7 million) rated AAA.
(2) Loans and advanced to credit institutions is Bank only.
(3) The net uncollateralised balance of derivative financial instruments was £0.6 million (2020: £nil) as set out in note 21, with counterparties rated A+.

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.

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

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

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

For all other classes of financial assets (as listed in note 18(i) on page 52), expected credit losses have been assessed as immaterial.

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk

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

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

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk

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

	Stage 1		Stage 2		Stage 3		POCI		Total	
Bank and Company **TSB**	**Gross** **£ million**	**ECL** **£ million**	**Gross** **£ million**	**ECL** **£ million**	**Gross** **£ million**	**ECL** **£ million**	**Gross** **£ million**	**ECL** **£ million**	**Gross** **£ million**	**ECL** **£ million**
At 1 January 2020	28,181.7	(52.3)	2,449.9	(60.8)	382.5	(47.7)	161.3	(2.2)	31,175.4	(163.0)
Transfers to credit impairment provisions	–	8.6	–	6.5	–	0.2	–	–	–	15.3
Changes reflected in impairment losses:										
Increases due to originations	7,594.3	(48.1)	80.0	(0.3)	15.5	–	6.3	–	7,696.1	(48.4)
Decreases due to repayments	(4,725.5)	16.9	(480.2)	4.0	(76.8)	2.5	(23.6)	–	(5,306.1)	23.4
Changes in credit risk[1]	–	30.1	–	(116.6)	–	(22.6)	–	(0.6)	-	(109.7)
Amounts written off	–	–	–	–	(67.0)	43.4	–	–	(67.0)	43.4
Transfers between stages [2] [3]	(1,297.0)	(22.1)	1,151.7	48.0	145,3	(25.9)	–	–	–	–
To stage 1	3,469.8	(107.9)	(3,454.0)	104.9	(15.8)	3.0	–	–	–	–
To stage 2	(4,746.3)	85.2	4,824.3	(90.7)	(78.0)	5.5	–	–	–	–
To stage 3	(20.5)	0.6	(218.6)	33.8	239.1	(34.4)	–	–	–	–
At 31 December 2020	29,753.5	(66.9)	3,201.4	(119.2)	399.5	(50.1)	144.0	(2.8)	33,498.4	(239.0)
Secured (retail)										
At 1 January 2020	26,747.4	(16.3)	1,976.9	(7.5)	303.7	(8.8)	161.2	(2.1)	29,189.2	(34.7)
Transfers to credit impairment provisions	–	–	–	–	–	0.1	–	–	–	0.1
Changes reflected in impairment losses:										
Increases due to originations	6,164.0	(32.4)	13.1	(0.3)	6.0	–	4.5	–	6,187.6	(32.7)
Decreases due to repayments	(4,193.9)	15.9	(317.1)	1.3	(53.0)	2.3	(21.9)	–	(4,585.9)	19.5
Changes in credit risk	–	10.3	–	(5.3)	–	0.1	–	(0.7)	–	4.4
Amounts written off	–	–	–	–	(0.5)	–	–	–	(0.5)	–
Transfers between stages	(943.7)	11.9	867.3	(8.0)	76.4	(3.9)	–	–	–	–
To stage 1	2,667.8	(7.8)	(2,656.9)	7.5	(10.9)	0.3	–	–	–	–
To stage 2	(3,607.4)	19.6	3,679.7	(21.3)	(72.3)	1.7	–	–	–	–
To stage 3	(4.1)	0.1	(155.5)	5.8	159.6	(5.9)	–	–	–	–
At 31 December 2020	27,773.8	(10.6)	2,540.2	(19.8)	332.6	(10.2)	143.8	(2.8)	30,790.4	(43.4)
Unsecured										
At 1 January 2020	1,316.2	(34.3)	463.4	(52.6)	75.3	(38.1)	0.1	(0.1)	1,855.0	(125.1)
Transfers to credit impairment provisions	–	8.3	–	6.4	–	0.1	–	–	–	14.8
Changes reflected in impairment losses:										
Increases due to originations	708.0	(13.1)	10.8	–	7.0	–	1.8	–	727.6	(13.1)
Decreases due to repayments	(357.3)	1.0	(143.8)	2.6	(20.9)	0.1	(1.7)	–	(523.7)	3.7
Changes in credit risk	–	8.2	–	(96.9)	-	(22.7)	–	0.1	–	(111.3)
Amounts written off	–	–	–	–	(66.2)	43.4	–	–	(66.2)	43.4
Transfers between stages:	(271.2)	(21.2)	204.4	42.7	66.8	(21.5)	–	–	–	–
To stage 1	676.5	(81.8)	(672.1)	79.5	(4.4)	2.3	–	–	–	–
To stage 2	(931.5)	60.1	936.6	(63.7)	(5.1)	3.6	–	–	–	–
To stage 3	(16.2)	0.5	(60.1)	26.9	76.3	(27.4)	–	–	–	–
At 31 December 2020	1,395.7	(51.1)	534.8	(97.8)	62.0	(38.7)	0.2	–	1,992.7	(187.6)
Business banking										
At 31 December 2020	118.1	(1.7)	9.6	(0.7)	3.5	(0.8)	–	–	131.2	(3.2)
Transfers to credit impairment provisions	–	0.3	–	0.1	–		–	–	–	0.4
Changes reflected in impairment losses:										
Increases due to originations	722.3	(2.6)	56.1	–	2.5	-	–	–	780.9	(2.6)
Decreases due to repayments	(174.3)	–	(19.3)	0.1	(2.9)	0.1	–	–	(196.5)	0.2
Changes in credit risk	–	11.6	-	(14.4)	–	–	–	–	–	(2.8)
Amounts written off	–	–	–	–	(0.3)	–	–	–	(0.3)	–
Transfers between stages:	(82.1)	(12.8)	80.0	13.3	2.1	(0.5)	–	–	–	–
To stage 1	125.5	(18.3)	(125.0)	17.9	(0.5)	0.4	–	–	–	–
To stage 2	(207.4)	5.5	208.0	(5.7)	(0.6)	0.2	–	–	–	–
To stage 3	(0.2)	–	(3.0)	1.1	3.2	(1.1)	–	–	–	–
At 31 December 2020	584.0	(5.2)	126.4	(1.6)	4.9	(1.2)	–	–	715.3	(8.0)

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk

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

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

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

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

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

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

Reconciliation to amounts recognised in the income statement

Bank	2021 £ million	2020 £ million
Changes in credit risk	**(11.7)**	136.0
Gross amounts written off	**56.1**	67.0
Less: Release of allowance associated with gross amounts written off	**(40.2)**	(43.4)
Income statement charge reported in ECL movement table on page 54	**4.2**	159.6
Recoveries of amounts previously written off	**(14.1)**	(12.1)
Other amounts charged to the income statement	**10.0**	16.5
Total credit impairment charge	**0.1**	164.0

Impairment losses recognised in the income statement totalled £0.1 million (2020: £164.0 million). These comprise of changes in the impairment allowance reflected in the lines under the heading 'changes reflected in impairment losses' in the table on page 54 together with the net amounts written off, again as reflected in the table on page 54. In addition, impairment losses include the subsequent recovery of amounts previously written off and other amounts charged directly to the income statement.

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk

(iv) Stage 2 balances

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

Bank and Company 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**

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

(v) Stage 3 balances

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

Balances that are credit impaired and not in a cure period comprise of loans and advances to customers that are more than 90 days past due, or considered by management as unlikely to pay their obligations, as described under the heading ‘definition of default for IFRS 9’ on page 35. 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). The PDs used to assign a risk grade, as shown in the table below, are point in time PDs. This is different to the IFRS 9 PDs used to assess IFRS 9 staging and expected credit loss measurement which are adjusted to reflect the effect of forward looking economic scenarios.

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

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

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

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)

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

(vii) Collateral held as security for financial assets

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

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

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

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

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

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

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

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

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

Notes to the 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. Liquidity 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 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(1)	**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.

Notes to the financial statements

Managing financial risk (continued)

19. Liquidity risk (continued)

Bank and Company At 31 December 2020	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
Financial liabilities measured at amortised cost:						
Customer deposits	32,041.5	342.4	875.2	1,116.2	–	34,375.3
Borrowings from central banks	0.8	900.0	1,315.0	850.0	–	3,065.8
Debt securities in issue	–	0.4	–	1,698.8	–	1,699.2
Subordinated liabilities	–	–	3.4	387.9	–	391.3
Lease liabilities	–	–	2.6	34.3	86.4	123.3
Other financial liabilities	51.6	–	–	–	–	51.6
Derivative liabilities at fair value through profit or loss	2.4	0.3	9.8	157.0	130.2	299.7
Hedging derivative liabilities	–	3.2	4.9	71.9	145.2	225.2
Other liabilities[(1)]	196.0	-	87.0	66.1	117.0	466.1
Total liabilities	32,292.3	1,246.3	2,297.9	4,382.2	478.8	40,697.5
Financial assets at amortised cost:						
Cash, cash balances at central banks	5,056.3	–	–	–	–	5,056.3
Debt securities	3.1	0.6	1.5	379.7	738.8	1,123.7
Loans and advances to customers	877.1	288.6	1,354.6	6,676.4	24,121.2	33,317.9
Loans and advances to credit institutions[(3)]	41.8	–	–	1.5	–	43.3
Loans and advances to central banks	120.9	–	–	–	–	120.9
Other advances	217.5	–	–	–	–	217.5
Financial assets at fair value through other comprehensive income	0.3	2.7	7.4	–	1,486.5	1,496.9
Derivative assets at fair value through profit or loss	0.8	0.6	5.8	180.7	10.4	198.3
Hedging derivative assets	–	–	4.4	70.6	64.9	139.9
Other assets[(2)]	175.3	3.4	21.2	168.7	339.1	707.7
Total assets	6,493.1	295.9	1,394.9	7,477.6	26,760.9	42,422.4

(1) Other liabilities comprise fair value adjustments for portfolio hedged risk, provisions and other liabilities.
(2) Other assets comprise fair value adjustments for portfolio hedged risk, property and equipment, intangible assets, deferred tax assets and other assets.
(3) Loans and advances to credit institutions 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 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**

Bank and Company At 31 December 2020	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	Total £ million
Financial liabilities measured at amortised cost:						
Customer deposits	32,043.7	343.5	900.7	1,127.1	–	34,415.0
Borrowings from central banks	0.8	900.2	1,316.6	850.3	–	3,067.9
Debt securities in issue	–	7.6	23.0	1,750.1	–	1,780.7
Subordinated liabilities	–	–	396.1	–	–	396.1
Lease liabilities	0.2	6.4	17.3	75.5	29.4	128.8
Other financial liabilities	51.6	–	–	–	–	51.6
Loan commitments	3,847.4	172.0	1,972.4	25.7	234.0	6,251.5
	35,943.7	1,429.7	4,626.1	3,828.7	263.4	46,091.6
Derivative financial instruments - outflows	15.3	97.6	97.7	282.4	205.4	698.4
Derivative financial instruments - inflows	(1.2)	(1.9)	(4.4)	(45.0)	(121.0)	(173.5)
Total financial liabilities	35,957.8	1,525.4	4,719.4	4,066.1	347.8	46,616.5

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 are 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 2021 £ million	Bank 2020 £ million	Company 2021 £ million	Company 2020 £ million
Shareholder's equity	**1,866.4**	1,724.9	**1,866.4**	1,724.9
Regulatory deductions	**(136.6)**	(124.5)	**(136.6)**	(124.5)
Common Equity Tier 1/Total Tier 1 capital	**1,729.8**	1,600.4	**1,729.8**	1,600.4
Tier 2 capital	**305.9**	432.8	**305.9**	432.8
Total capital resources	**2,035.7**	2,033.2	**2,035.7**	2,033.2

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.

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.

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

Derivative financial instruments

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	2021				2020			
Derivative financial instruments not in hedge accounting relationships	**Contract/ notional amount £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Gain/(loss) recognised in profit or loss £ million**	**Contract/ notional amount £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Gain(loss) recognised in profit or loss £ million**
Interest rate swaps	**24,964.2**	**168.4**	**(156.5)**	**(2.5)**	20,790.4	198.3	(299.7)	(0.5)
Foreign exchange forwards	–	–	–	–	–	–	–	–
Equity forwards and options	–	–	–	–	–	–	–	(0.8)
Total	**24,964.2**	**168.4**	**(156.5)**	**(2.5)**	20,790.4	198.3	(299.7)	(1.3)

Company	2021				2020			
Derivative financial instruments not in hedge accounting relationships	**Contract/ notional amount £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Gain/(loss) recognised in profit or loss £ million**	**Contract/ notional amount) £ million**	**Assets fair value £ million**	**Liabilities fair value £ million**	**Gain(loss) recognised in profit or loss £ million**
Interest rate swaps	**24,964.2**	**168.4**	**(156.5)**	**(2.5)**	20,790.4	198.3	(299.7)	(0.5)
Foreign exchange forwards	–	–	–	–	–	–	–	–
Equity forwards and options	–	–	–	–	–	–	–	(0.8)
Total	**24,964.2**	**168.4**	**(156.5)**	**(2.5)**	20,790.4	198.3	(299.7)	(1.3)

Notes to the financial statements

Managing financial risk (continued)

21. Market risk (continued)

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

Risk management

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

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

IBOR reform

Background

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

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

Notes to the financial statements

Managing financial risk (continued)

21. Market risk (continued)

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

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 dedesignate these hedge relationships and redesignate new relationships on a monthly basis. The provisions of the UK adopted version of IAS 39 mean that ineffectiveness arising due to unexpected prepayments need not be recognised though profit or loss, so long as hedge designations are made in such a way to minimise their impact.

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

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

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

Notes to the financial statements

Managing financial risk (continued)

21. Market risk (continued)

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

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

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

Notes to the financial statements

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

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

Reconciliation of reserves in respect of hedge accounting

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

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

(1) In respect of the Company, movements in the cash flow hedge reserve during 2020 are as set out in the table above, with the exception of foreign exchange risk.

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				Related amounts where set off in the balance sheet is not permitted		
At 31 December 2021	Gross amounts £ million	Amounts offset £ million	Net amounts reported on the balance sheet £ million	Related financial instrument amounts not offset £ million	Cash collateral received/ pledged[1] £ million	Potential Net amount £ million
Derivative financial assets	**412.9**	**–**	**412.9**	**(276.3)**	**(136.2)**	**0.4**
Derivative financial liabilities	**293.3**	**–**	**293.3**	**(276.3)**	**(17.0)**	**–**
At 31 December 2020						
Derivative financial assets	338.2	–	338.2	(338.2)	–	–
Reverse repurchase agreements	225.8	(225.8)	–	–	–	–
Other assets	367.2	(192.6)	174.6	–	–	174.6
Derivative financial liabilities	(524.9)	–	(524.9)	338.2	186.7	–
Repurchase agreements	(225.8)	225.8	–	–	–	–
Other liabilities (note 30)	(388.6)	192.6	(196.0)	–	–	(196.0)

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

Company				Related amounts where set off in the balance sheet is not permitted		
At 31 December 2021	Gross amounts £ million	Amounts offset £ million	Net amounts reported on the balance sheet £ million	Related financial instrument amounts not offset £ million	Cash collateral received/ pledged[1] £ million	Potential Net amount £ million
Derivative financial assets	**412.9**	**–**	**412.9**	**(276.3)**	**(136.2)**	**0.4**
Derivative financial liabilities	**293.3**	**–**	**293.3**	**(276.3)**	**(17.0)**	**–**
At 31 December 2020						
Derivative financial assets	338.2	–	338.2	(338.2)	–	–
Reverse repurchase agreements	225.8	(225.8)	–	–	–	–
Other assets	410.4	(192.6)	217.8	–	–	217.8
Derivative financial liabilities	(524.9)	–	(524.9)	338.2	186.7	–
Repurchase agreements	(225.8)	225.8	–	–	–	–
Other liabilities (note 30)	(388.5)	192.6	(195.9)	–	–	(195.9)

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

Notes to the 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 2020	79.4	195.6	412.8	13.6	(2.5)	1,201.9
Net change in fair value reserve	–	–	–	(2.0)	–	–
Net change in cash flow hedging reserve	–	–	–	–	(17.7)	–
Loss for the year	–	–	–	–	–	(156.2)
Balance at 31 December 2020	**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**	**–**
Loss for the year	**–**	**–**	**–**	**–**	**–**	**128.4**
At 31 December 2021	**79.4**	**195.6**	**412.8**	**11.1**	**(6.6)**	**1,174.1**

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 2020	79.4	195.6	412.8	13.6	(2.3)	1,212.6
Net change in fair value reserve	–	–	–	(2.0)	–	–
Net change in cash flow hedging reserve	–	–	–	–	(17.9)	–
Loss for the year	–	–	–	–	–	(166.9)
At 31 December 2020	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**	**–**
Loss for the year	**–**	**–**	**–**	**–**	**–**	**128.4**
At 31 December 2021	**79.4**	**195.6**	**412.8**	**11.1**	**(6.6)**	**1,174.1**

Notes to the financial statements

Other important disclosures (continued)

22. Shareholder's equity (continued)

At 31 December 2021 and 2020, TSB Bank plc had in issue 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.

23. Contingent liabilities

Significant judgement

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

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

More broadly, during the ordinary course of business, TSB may be subject to other complaints and threatened or actual legal proceedings brought by customers that may result in legal and regulatory reviews, challenges, investigations and enforcement actions. Any such material cases are periodically reassessed, with the assistance of external professional advisers where appropriate, to determine the likelihood of incurring a liability. TSB does not disclose amounts in relation to contingent liabilities associated with such claims where the likelihood of any payment is remote. TSB also does not disclose an estimate of the potential financial impact or effect on the Bank of contingent liabilities where it is not currently practicable to do so. The Bank 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 authority and 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	2021 £ 000	2020 £ 000
Short term employee benefits	**9,191**	5,597
Post-employment benefits	**802**	730
Other long term benefits	**–**	–
Share-based payments	**574**	–
Payments for loss of office	**–**	459
Total	**10,567**	6,786

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

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

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

Notes to the financial statements

Other important disclosures (continued)

24. Related party transactions (continued)

(i) Key management personnel (continued)

Bank and Company	2021 £ 000	2020 £ 000
Deposits		
At 1 January	**1,913**	1,797
Deposits made during the year (includes key management personnel appointed during the year)	**5,557**	4,471
Interest expense on deposits	**1**	7
Withdrawals made during the year (including key management personnel resigned during the year)	**(7,244)**	(4,361)
At 31 December	**247**	1,914

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 due from TSB Banking Group plc, the Company's immediate parent company, totalled £17.2 million (2020: £18.3 million) primarily arise from the payment and recharge, in the normal course of business, of certain costs of TSB Banking Group plc and the funding by the Company of collateral balances required to be deposited by TSB Banking Group plc. Amounts payable to TSB Banking Group plc totalled £1.1 million (£202: £nil).

Amounts due from TSB Banking Group Employee Share Trust (EST) totalled £1.6 million (2020: £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 receivable from other Bank companies by the Company were £56.1 million (2020: £43.2 million).

(iii) Transactions and balances with Sabadell Group companies

Operational IT costs

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

Residual IT Migration related balances

In connection with the IT migration in 2018, the Migration Services Agreement (MSA) and OSA contracts provided TSB with the right to seek recovery of eligible losses for breach of contract up to the level of liability caps in each agreement. In December 2021, a Settlement Agreement was entered in to by the respective parties. This represented full and final settlement of TSB's £192.6 million claim against Sabis, which extinguished a corresponding withheld amount that was payable by TSB to Sabis under the MSA and OSA contracts. At 31 December 2021, the aggregate liability to Sabis was £6.9 million, representing business as usual amounts payable under the OSA contract (note 30 on page 77).

At 31 December 2020, the respective parties had reached provisional agreement, subject to mutual reservations of rights while negotiations were concluded, to recognise an aggregate estimated recovery under the agreements of £192.6 million, reflecting the maximum recovery amount under the contracts. As TSB intended to settle on a net basis, the residual MSA liability of £100.0 million was presented on the statement of financial position net of the recovery of £100.0 million. The amount payable to Sabis in respect of the OSA and other change services of £113.9 million was presented net of recovery of £92.6 million. Taken together, at 31 December 2020, the aggregate liability to Sabis was £21.3 million (note 30).

Senior unsecured debt securities

In December 2020, TSB Bank plc issued £450.0 million of floating rate notes with a maturity date of June 2023 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 2.1%. Interest expense of £9.7 million (2020: £0.1 million) was recognised and £0.1 million was payable at 31 December 2021 (2020: £0.1 million).

Subordinated liabilities

In March 2021, TSB 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 £7.8 million (2020: £nil) was recognised and £0.1 million was payable at 31 December 2021 (2020: £nil).

Notes to the financial statements

Other important disclosures (continued)

24. Related party transactions (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 £2.1 million (2020: £1.9 million). Sabadell acts as guarantor to TSB's borrowings under the TFSME. Under this arrangement guarantee fees of £5.2 million (2020: nil) were recognised and £2.5 million (2020: nil) was payable at 31 December 2021.

(iv) Subsidiary undertakings
TSB Covered Bonds LLP, TSB Covered Bonds (LM) Limited, and TSB Covered Bonds (Holdings) Limited are accounted for as subsidiary companies of TSB Bank plc as it exercises control of each entity under IFRS 10 Consolidated Financial Statements. The registered office of each of these entities is 35 Great St Helen's, London, EC3A 6AP*:*

25. Property and equipment

Bank and Company	Property £ million	Equipment £ million	Right of use leasing asset £ million	Total £ million
Cost				
At 1 January 2020	245.8	111.4	167.3	524.5
Additions	10.5	23.8	5.1	39.4
Disposals	(22.3)	(12.4)	(5.2)	(39.9)
Lease term remeasurement (note 26)	–	–	1.5	1.5
Write-offs	–	–	–	–
At 31 December 2020	**234.0**	**122.8**	**168.7**	**525.5**
Additions	**16.9**	**29.6**	**12.8**	**59.3**
Disposals	**(78.4)**	**(60.1)**	**(11.0)**	**(149.5)**
Lease term remeasurement (note 26)	**–**	**–**	**60.0**	**60.0**
At 31 December 2021	**172.5**	**92.3**	**230.5**	**495.3**
Accumulated depreciation				
At 1 January 2020	125.8	77.8	27.7	231.3
Depreciation charge for property and equipment	27.8	14.0	–	41.8
Depreciation charge for right of use asset	–	–	25.8	25.8
Disposals	(19.3)	(12.3)	(0.7)	(32.3)
At 31 December 2020	**134.3**	**79.5**	**52.8**	**266.6**
Depreciation charge for property and equipment (note 14)	**22.4**	**15.0**	**–**	**37.4**
Depreciation charge for right of use asset (note 14)	**–**	**–**	**25.1**	**25.1**
Disposals	**(69.8)**	**(56.0)**	**(8.3)**	**(134.1)**
At 31 December 2021	**86.9**	**38.5**	**69.6**	**195.0**
Carrying amount				
At 31 December 2020	99.7	43.3	115.9	258.9
At 31 December 2021	**85.6**	**53.8**	**160.9**	**300.3**

At 31 December 2021, property held for sale totalled £1.6 million (2020: £0.4 million). The net book value represented the recoverable amount and no impairment was required.

Notes to the financial statements

Other important disclosures (continued)

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 2021 £ million	Property 2020 £ million
Balance at 1 January	**123.3**	141.8
Additions	**0.4**	5.1
Lease term remeasurement	**60.0**	1.5
Interest expense for the year	**2.6**	1.3
Lease payments made in the year	**(22.8)**	(26.4)
Carrying amount at 31 December	**163.5**	123.3

As part of a wider strategic property review, during 2021 the lease terms of relevant properties were reassessed. This resulted in an increase in the lease liability of £60.0 million and a corresponding increase in the associated right of use assets (note 25).

The estimation of lease term requires judgement. An increase or decrease in the estimated lease term of one year would have increased/decreased the lease liability, and the corresponding right of use asset, by £8 million.

27. Intangible assets

Bank and Company	2021 £ million	2020 £ million
Cost		
At 1 January	**66.4**	30.5
Additions	**32.1**	35.9
Disposals	**(3.6)**	–
At 31 December	**94.9**	66.4
Accumulated amortisation		
At 1 January	**16.9**	10.2
Amortisation charge for the year (note 14)	**7.7**	6.7
Disposals	**(1.8)**	–
At 31 December	**22.8**	16.9
Carrying amount	**72.1**	49.5

28. Other assets

	Bank 2021 £ million	Bank 2020 £ million	Company 2021 £ million	Company 2020 £ million
Other assets and prepayments	**130.3**	143.8	**130.3**	143.8
Amounts recoverable under customer remediation indemnity	**6.9**	10.9	**6.9**	10.9
Amounts due from other TSB Group companies (note 24)	**18.8**	19.9	**74.9**	63.1
Total other assets	**156.0**	174.6	**212.1**	217.8

Notes to the financial statements

Other important disclosures (continued)

29. Provisions

Bank and Company	Customer redress provisions £ million	Restructuring provisions £ million	Credit impairment provisions £ million	Dilapidations provisions £ million	Total £ million
At 1 January 2021	**66.1**	**67.8**	**19.2**	**–**	**153.1**
Transfers	**–**	**(7.1)**	**–**	**7.1**	**–**
Increase/(decrease)	**(3.1)**	**12.7**	**(2.5)**	**13.9**	**21.0**
Utilisation	**(3.5)**	**(59.0)**	**–**	**(1.4)**	**(63.9)**
At 31 December 2021	**59.5**	**14.4**	**16.7**	**19.6**	**110.2**

(1) The increase in restructuring provisions includes £2.2 million of remediation expense in respect of the collection and recovery conduct charges matter.

Significant estimates

Customer redress provisions
During 2020, management and the FCA commenced a review of support treatments offered to some customers who are, or were, in arrears and being serviced by TSB's collections and recoveries department which has identified potentially impacted customers over a period from 2013 to 2020 who may have suffered either financial loss or distress and inconvenience. While the review is not yet complete, the assessment of the potential cost of customer redress, including compensatory interest, and related operational costs has been refined during 2021. While the proposed approach to customer redress has taken account of discussions with the skilled person appointed by the FCA, it has yet to be formally agreed with the FCA.

The costs of redress are estimated to lie within a range of £49.4 million to £56.6 million (2020: £53.1 million to £57.4 million). The key judgements to which the estimate is sensitive, and which are the primary drivers of the £7.2 million range in estimated cost, relate to:

- a small number of cohorts of customers where the cost of redress lies within an estimated range of between £2.0 million and £4.2 million, dependent on assumed rates of redress and the number of impacted customers; and
- the degree to which previously applied fees and charges have been already refunded resulting in a reduction of estimated costs of between £2.0 million and £5.4 million.

A provision of £54.3 million (2020: £55.0 million) is carried and is expected to be utilised over the next two years.

Dilapidation provisions
During 2021, the dilapidation provision was reassessed as part a wider strategic property review. This assessment resulted in an increase of £12.8 million in the provision, included within the increase of £13.9 million reported above. In addition, £7.1 million of dilapidation provision previously recognised as part of previous restructuring was reclassified to this category. The estimation of the amount and timing of payments to landlords as part of contractual dilapidation obligations requires judgement. In estimating the provision, experience gained from recent branch closures was used, together with supporting evidence from property advisors. An increase/decrease of 10% to the average dilapidation rate per leasehold branch would have increased/decreased the provision balance at 31 December 2021 by £2.0 million.

Restructuring provisions
At 31 December 2021, TSB carried provisions of £23.2 million (2020: £67.8 million) in respect of estimated costs to restructure the Bank as part of TSB's strategy. This included estimated costs in respect of the closure of 70 branches that were announced in November 2021 and residual costs in respect of earlier phases of branch closures announced. The amounts are expected to be settled during 2022.

Credit impairment provisions
Credit impairment provisions are in respect of off balance sheet lending commitments and primarily relates to provisions in respect of undrawn credit card limits and current account overdrafts. This provision is measured and managed as part of the overall assessment of expected credit losses. Sensitivity of total expected credit losses to alternative economic scenarios is set out in note 8 on page 41.

Notes to the financial statements

Other important disclosures (continued)

30. Other liabilities

Bank	2021 £ million	2020 £ million
Amounts payable to Sabadell Group companies (note 24)	**6.9**	21.3
Amounts payable to other TSB Group companies	**1.1**	–
Accruals and deferred income	**84.7**	87.6
Share based payment liability	**5.3**	4.1
Other creditors	**99.8**	83.0
Total other liabilities	**197.8**	196.0

Company	2021 £ million	2020 £ million
Amounts payable to Sabadell Group companies (note 24)	**6.9**	21.3
Amounts payable to other TSB Group companies (note 24)	**1.1**	–
Accruals and deferred income	**84.7**	87.6
Share based payment liability	**5.3**	4.1
Other creditors	**99.8**	82.9
Total other liabilities	**197.8**	195.9

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	Amounts due from other TSB Group companies £ million	Total non customer funding £ million
At 1 January 2020	4,483.5	1,676.3	395.9	–	6,555.7
Repayment of borrowings from central banks (net)	(1,410.0)	–	–	–	(1,410.0)
Repayment of securitisation funding	–	(440.2)	–	–	(440.2)
Issuance of senior unsecured debt securities	–	450.0	–	–	450.0
Exchange differences	–	13.7	–	–	13.7
Non-cash movements	(7.7)	(0.6)	(4.6)	–	(12.9)
At 31 December 2020	**3,065.8**	**1,699.2**	**391.3**	**–**	**5,156.3**
Additional borrowings from central banks	**5,500.0**	**–**	**–**	**–**	**5,500.0**
Repayment of borrowings from central banks	**(3,065.0)**	**–**	**–**	**–**	**(3,065.0)**
Issue of subordinated liabilities	**–**	**–**	**300.0**	**–**	**300.0**
Repayment of subordinated liabilities	**–**	**–**	**(385.0)**	**-**	**(385.0)**
Issuance of covered bonds	**–**	**500.0**	**–**	**–**	**500.0**
Non-cash movements	**0.8**	**(0.1)**	**(14.5)**	**–**	**(13.8)**
At 31 December 2021	**5,501.6**	**2,199.1**	**291.8**	**–**	**7,992.5**

Notes to the financial statements

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	Amounts due from other TSB Group companies £ million	Total non customer funding £ million
At 1 January 2020	4,483.5	1,249.8	395.9	10.4	6,139.6
Repayment of borrowings from central banks (net)	(1,410.0)	–	–	–	(1,410.0)
Repayment of securitisation funding	–	–	–	(10.4)	(10.4)
Issuance of senior unsecured debt securities	–	450.0	–	–	450.0
Non-cash movements	(7.7)	(0.6)	(4.6)	–	(12.9)
At 31 December 2020	**3,065.8**	**1,699.2**	**391.3**	**–**	**5,156.3**
Additional borrowings from central banks	**5,500.0**	**–**	**–**	**–**	**5,500.0**
Repayment of borrowings from central banks	**(3,065.0)**	**–**	**–**	**–**	**(3,065.0)**
Issue of subordinated liabilities	**–**	**–**	**300.0**	**–**	**300.0**
Repayment of subordinated liabilities	**–**	**–**	**(385.0)**	**–**	**(385.0)**
Issuance of covered bonds	**–**	**500.0**	**–**	**–**	**500.0**
Non-cash movements	**0.8**	**(0.1)**	**(14.5)**	**–**	**(13.8)**
At 31 December 2021	**5,501.6**	**2,199.1**	**291.8**	**–**	**7,992.5**

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

	Bank 2021 £ million	Bank 2020) £ million	Company 2021 £ million	Company 2020 £ million
Increase in loans to central banks	**(22.7)**	(24.8)	**(22.7)**	(24.8)
(Increase)/decrease in loans to credit institutions	**(12.8)**	329.9	**–**	–
Increase in loans and advances to customers	**(4,070.2)**	(2,402.4)	**(4,070.2)**	(2,402.4)
Decrease in reverse purchase agreements	**–**	201.1	**–**	201.1
Decrease in other advances	**136.8**	62.1	**136.8**	62.1
Net change in derivative financial instruments and fair value adjustment for portfolio hedged risk	**(147.6)**	(216.0)	**(147.6)**	(201.5)
Decrease/(increase) in other assets	**18.6**	(25.4)	**5.7**	(68.6)
(Decrease)/increase in deposits from credit institutions	**–**	4.2	**–**	4.2
Increase in customer deposits	**1,591.2**	4,217.0	**1,591.2**	4,217.0
Increase/ (decrease) in other financial liabilities	**141.9**	(33.3)	**141.9**	(33.3)
(Decrease)/increase in provisions	**(40.4)**	101.3	**(40.4)**	101.3
Increase in other liabilities	**0.7**	41.9	**0.8**	41.9
Change in operating assets and liabilities	**(2,404.5)**	2,255.6	**(2,404.5)**	1,897.0
Depreciation and amortisation	**70.2**	74.3	**70.2**	74.3
Impairment losses on loans and advances to customers	**2.6**	162.7	**2.6**	162.7
Exchange differences	**–**	13.7	**–**	–
Other non-cash items	**39.2**	28.7	**39.2**	(14.7)
Non-cash and other items	**112.0**	279.4	**112.0**	222.3
Analysis of cash and cash equivalents as shown in the balance sheet				
Cash	**100.7**	143.6	**100.7**	143.6
Balances with central banks	**4,741.5**	4,910.1	**4,741.5**	4,910.1
On demand deposits	**8.9**	2.6	**8.9**	2.6
Total cash and cash equivalents	**4,851.1**	5,056.3	**4,851.1**	5,056.3

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 26 January 2022.

The Company's ultimate parent company and ultimate controlling party is Banco de Sabadell, S.A. (incorporated in Spain), which is also the parent undertaking of the largest group of undertakings for which consolidated financial statements are drawn up and of which the Company is a member. 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 Group") for the year ended 31 December 2021 which comprise the consolidated balance sheet, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated cash flow statement, Parent Company balance sheet, Parent Company statement of changes in equity, Parent Company cash flow statement, and the related notes, including the accounting policies.

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 December 2021 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with UK-adopted international accounting standards;
- the parent Company financial statements have been properly prepared in accordance with UK-adopted international accounting standards and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

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

We were first appointed as auditor by the shareholders on 5 May 2020. The period of total uninterrupted engagement is for the two financial years ended 31 December 2021. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

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

Independent auditor's report to the members of TSB 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 2020: ◄►** ***31 December 2021: £189.6 million*** ***(31 December 2020: £239.0 million)*** ***Refer to note 8 (accounting policy and 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 COVID-19. 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, particularly in the context of COVID-19, and the probability weightings assigned to each economic scenario. • **Qualitative adjustments** – Adjustments to the model-driven ECL results are raised by the Group to address issues relating to model limitations, model responsiveness or emerging trends including those relating to COVID-19. Certain adjustments are inherently uncertain and significant judgement is involved in estimating these amounts. • **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 estimations** – Inherently judgmental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD'). The LGD model used in the secured portfolio and the PD models used in the unsecured portfolios are the key drivers of the Group's ECL results and are therefore the most significant judgmental aspects of the Group's ECL modelling approach. 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.	Our audit procedures included: **Test of details:** We recalculated the ECL measured on each of TSB's loan portfolios. We performed sample testing over key inputs, data and assumptions impacting ECL calculations to assess the reasonableness of economic forecasts, weights, and model assumptions applied. **Our economic scenario expertise:** We involved our own economic specialists to assist us in assessing the appropriateness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them. We assessed the overall reasonableness of the economic forecasts by comparing the Group's forecasts to our own modelled forecasts. As part of this work we challenged the reasonableness of the Group's considerations of the economic uncertainty relating to COVID-19. **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. **SICR**: We assessed the ongoing effectiveness of the SICR criteria and independently calculated the loans' stage for TSB'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. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgments and assumptions made was sufficiently clear. **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 (2020: 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 2020: ◄►**	***Data capture and integrity*** The Group has self-acknowledged historical issues with the design and implementation of controls within the Group's IT control environment, specifically in relation to user access and change management. During 2021 the Group has continued to work on improving the IT control environment. The Group's accounting and reporting processes are dependent on automated controls (such as data feeds or automated calculations) enabled by IT systems. These are then supported by general IT controls ('GITCs') covering areas such as access and change management and batch processing, which ensure the integrity of the Group's IT systems. There is a risk that, if the GITCs are not effective, then inappropriate access could be gained to IT applications and inappropriate changes made to the application itself or to the integrity of related automated controls. 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:** **Risk assessment:** We performed a risk assessment of the Bank's general IT control environment and the status of the Group's IT remediation programme to assess their impact on our audit approach. **Control testing:** We tested the design, implementation and operating effectiveness of relevant controls over granting, removal and modification of access rights, including privileged access rights, change management and batch processing. For a sample of changes, we assessed that each change was appropriately tested, approved and appropriate segregation of duties was in place. **Test of details**: We assessed the appropriateness of the privileged access rights granted to applications and databases relevant to financial accounting and reporting systems and investigated identified exceptions. For relevant batch jobs, we assessed that resolutions were appropriately identified and resolved. **Extended scope:** As a result of the above, we extended our audit testing to address deficiencies identified, including: • Where, despite not being able to rely on the associated general IT controls, we decided to continue to place reliance on selected automated controls, including those which support the allocation of payments, we increased the frequency with which we manually tested the operation of these automated controls during the period subject to audit. This approach allowed us to assess whether the deficiencies identified had impacted the operation of the specific automated control we wanted to rely on. • We identified and placed reliance on selected manual controls where appropriately designed to mitigate the same process risk as the relevant automated control. • We performed incremental substantive procedures to mitigate the same process risk as the relevant automated control. Procedures included: ○ Sample testing to agree relevant data elements used in the financial reporting process, including customer and transactional data, to appropriate supporting evidence. As we did not place reliance on certain GITCs, we increased our sample sizes for this testing; and ○ Where we performed substantive testing over areas such as data calculations, we increased our sample sizes because we did not place reliance on relevant GITCs.

Independent auditor’s report to the members of TSB 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 (continued)		**Our results:** We aligned our testing of GITCs to the Group’s IT remediation project during the year and identified certain automated controls that we could rely on in our audit. This was either because GITCs were effective or we were able to satisfy ourselves, through the additional work described above, that the deficiencies identified had not impacted the specific automated control. As a result of our testing of the general IT control environment and through the performance of the above incremental, mitigating procedures, we have therefore been able to reduce the audit risk relating to IT access, change management and operations to an acceptable level. (2020: We did not test GITCs). With regard to automated controls, we did not identify any significant deficiencies or any material errors in the relevant data elements that we tested (2020: We did not identify any significant deficiencies in the automated controls or any material errors in the relevant data elements which we tested).

We continue to consider the impact of macroeconomic uncertainty on our audit. The financial statements explain how the Directors have incorporated the impact of macroeconomic uncertainty in their determination of ECL provisions. Our response to this matter is set out in more detail in the Key Audit Matter above. The financial statements also explain how the Directors have formed a judgement that it is appropriate to adopt the going concern basis of preparation for the Group and Parent Company. This judgement takes into account all relevant aspects including the impact of the macroeconomic environment. However, following the more favourable COVID-19 macroeconomic outlook as at 31 December 2021, we have not assessed this as one of the most significant risks in our current year audit and, therefore, it is not separately identified in our report this year.

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

Materiality for the financial statements as a whole was set at £10.0 million (2020: £7.5 million), determined with reference to a benchmark of total revenue, of which it represents 1.02% (2020: 0.81%).

Materiality for the Parent Company financial statements as a whole was set at £10.0 million (2020: £7.5 million), determined with reference to a benchmark of total revenue, of which it represents 1.02% (2020: 0.81%).

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

Performance materiality for the Group and Parent Company was set at 65% (2020: 65%) of materiality for the financial statements as a whole, which equates to £6.5 million (2020: £4.88 million). Last year’s performance materiality reflected the fact that it was our first year as auditors and we did not test general IT controls. The performance materiality percentage remains unchanged from last year on the basis that this is the first year we planned to test general IT controls.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.5 million (2020: £0.375 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

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

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

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 including the impact in which the global COVID-19 pandemic continues to unfold; and
- the impact on regulatory capital requirements in the event of an economic slowdown or recession.

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

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

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 24 (basis of preparation) to be acceptable.

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

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

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

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

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

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

5 Fraud and breaches of laws and regulations – ability to detect (continued)
As required by auditing standards, and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, in particular the risk that Group management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements such as ECL on loans and advances to customers. On this audit we do not believe there is a fraud risk related to revenue recognition because there is limited complexity in the calculation and recognition of revenue.

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

We also performed procedures including:

- Identifying journal entries to test based on risk criteria and comparing the identified entries to supporting documentation. These included those posted by senior finance management and those posted and approved by the same user; and
- Assessing significant accounting estimates for bias.

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

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

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

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

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

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

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

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

For the joint regulatory investigation matter discussed in note 23, our procedures included inquiries with internal and external legal counsel as to the status of the investigation.

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

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 these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. Our audit procedures are designed to detect material misstatement. We are not responsible for preventing non-compliance or fraud and cannot be expected to detect non-compliance with all laws and regulations.

6 We have nothing to report on the other information in the Annual Report
The directors are responsible for the other information presented in the Annual Report together with the financial statements. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

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

Strategic report and directors' report
Based solely on our work on the other information:

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

7 We have nothing to report on the other matters on which we are required to report by exception
Under the Companies Act 2006, we are required to report to you if, in our opinion:

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

We have nothing to report in these respects.

8 Respective responsibilities

Directors' responsibilities
As explained more fully in their statement set out on page 23, 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.

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

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

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

Pamela McIntyre (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
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27 January 2022

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