TSB Bank plc

Annual Report and Accounts 2023

Registered in Scotland
Company Number: SC095237

TSB Bank plc

Annual report and consolidated financial statements
For the year ended 31 December 2023

Overview

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

Contents

Directors and Company Secretary

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

Chairman:	Nick Prettejohn (independent on appointment)
Executive Directors:	Robin Bulloch (Chief Executive)
	Declan Hourican (Chief Financial Officer)
Independent Non-executive Directors:	Zahra Bahrololoumi (appointed 17 March 2023)
	Adam Banks
	Elizabeth Chambers
	Judith Eden (appointed 1 January 2024)
	Ahmed Essam (appointed 17 March 2023)
	Lynne Peacock (Senior Independent Director)
	Mark Rennison (resigned 31 August 2023)
	Andy Simmonds
Non-executive Directors:	Leopoldo Alvear
	Marc Armengol
	Carlos Paz
Company Secretary:	Keith Hawkins

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

Strategic report

Review of business performance

Introduction
Ten years after separating from Lloyds Banking Group and returning to the high street as a standalone bank, TSB has firmly established itself as a leading challenger bank. The Bank's tenth anniversary in September was an occasion not only for reflecting on just how far TSB has come, but also to look forward to what TSB can achieve in the future.

In 2023, the first full year of TSB's 2025 strategy, we delivered further profit growth by continuing to adapt and improve our services to meet the needs of our customers.

As the cost of living pressures continued, many households and businesses found themselves under mounting strain. Against this backdrop, it has been more important than ever that TSB has remained laser-focused on our purpose – Money Confidence. For everyone. Every day.

TSB provided support to customers in need, contacting those that we consider to be at heightened risk of falling into financial difficulties. We have also helped customers access grants and other sources of funding to which they may be entitled through a ground-breaking partnership with Lightning Reach. For mortgage customers, we moved quickly to put in place the government's Mortgage Charter and led the way in extending similar support to our Buy-to-Let customers.

In spite of the challenging economic conditions, TSB has continued to compete well and perform strongly with profit before tax increasing 30% to £235.5 million. This demonstrates the underlying strength of TSB's business and our sustained increase in profitability in recent years serves as a strong indicator that we have the right strategy and are executing it well.

In 2023, we have seen a steady improvement in how TSB customers perceive our service, with more customers saying that they would recommend TSB to their friends and families, and that we are helping them have greater Money Confidence – clear evidence of the progress we are making in delivering our purpose.

It is clear, too, that colleagues are fully behind our strategy and believe strongly in TSB's purpose. In the most recent survey, we saw an improvement in colleagues' responses to questions in these areas, to levels we have not seen since returning as a standalone bank. I believe that colleague engagement has played a vital role in the progress TSB has made, and maintaining this level will be central to the Bank's continued success.

Despite inflationary pressures we have kept a firm control on costs through the year. This has helped ensure that the Bank's overall financial performance remained strong. At the same time, we continued to invest in strengthening TSB's technology capability and resilience to provide banking systems on which customers and colleagues can continue to rely.

With more solid foundations in place, we can add further features and services to our digital proposition, while also providing our customers with more opportunities to speak to us in person – in our branches, TSB Pods and pop-up services across the country, on the phone, and increasingly by video banking, where we already offer a broader range of services than most other high street banks. Our work to drive further simplification and efficiency continues. Whilst reducing our costs, by investing where it matters most we can provide a seamless, high-quality banking experience for our customers, so they can meet all their financial needs through the channel of their choice, at a time and place that's most convenient for them.

Our 2025 strategy has four key elements, and we've made strong progress in each of them this year.

Customer Focus
- Customers have continued to take advantage of our increased savings rates and current account features, with 289,000 (2022: 205,000) new savings accounts opened this year and £2.5 million (2022: £1.3 million) in cashback payments to current account customers. We were awarded 'Best Everyday Savings Account Provider' and 'Best Junior Cash ISA Provider' by *Your Money*.
- Our award-winning mortgage intermediary and operations team helped more than 7,800 first-time buyers get onto the property ladder.
- We have proactively contacted over 190,000 customers that we consider at heightened risk of falling into financial difficulty to offer assistance and support. We also moved quickly to put in place the government's Mortgage Charter and led the way in extending similar support to Buy-to-Let customers.
- Our partnership with Lightning Reach (launched in April) is helping customers in financial hardship to identify eligible grants and funds in addition to benefits. So far, more than 3,700 customers have registered for the service.

Strategic report

Review of business performance (continued)

Service Excellence

- We have expanded our video banking capability to provide additional opening hours over the weekend.
- We've held over 21,000 mortgage video appointments with all TSB mortgage advisers trained to use video. We also held over 23,000 general banking appointments over video, with almost a third out of hours.
- New features have been added to the TSB Mobile Banking app, including mobile cheque deposit, contactless controls, gambling blocks and a new Mortgage Servicing Hub.
- At the end of the year, our Net Promoter Score (NPS, a measure of how likely customers would be to recommend TSB), was the highest it has been for the past two years at +16% (2022: +5%), while in November the contact centre NPS was the highest it has been over the same period at +52%.

Simplification and Efficiency

- TSB's cost-to-income ratio (statutory basis) improved by 5.0 percentage points to 73.7% (2022: 78.7%).
- We've continued to invest in our physical banking services, closing nine of our quieter branches and opening three new shopping-centre Pods in Wood Green, Wigan and Luton, all of which offer cash withdrawals and deposits.
- We serve customers based on their requirements, using a multi-channel model that includes digital and telephone banking and a national branch network and continue to tailor these offerings to customer demand. We currently retain the 7th largest network with 211 high-street branches, complemented by over 40 pop-up branches and three Pods, serving communities across Great Britain. We're also one of the member banks providing funding for Cash Access UK, enabling solutions such as Banking Hubs and Enhanced Post Offices in key areas across the UK.

Do What Matters

- Our Fraud Refund Guarantee continues to lead the industry in protecting customers, refunding 97% (2022: 97%) of all fraud cases compared to the industry average of 64% (2022: 56%). TSB's leading position has also helped bring about a step-change for consumers, as government and Payment Systems Regulator (PSR) rules come into force this year mandating all banks to reimburse fraud victims.
- We're continuing to make strong progress on our goals for Black, Asian and minority ethnic representation, which increased in 2023 to 16% across all grades (against a goal of 14%) and 12% at our senior grades (goal: 10%). Further, in July, 36 colleagues graduated from our Ignite programme, aimed at supporting Black and Black mixed-heritage colleagues to advance their careers at TSB, with a quarter of these being promoted or moving roles during the programme.
- We've continued to support victims of domestic abuse. In addition to all branches being part of Hestia's Safe Spaces initiative, we launched Online Safe Spaces to support victims of domestic abuse and around 200 customers accessed our Emergency Flee Fund. We have also extended our Flee Fund support to colleagues.
- We continue to be the only high-street bank accredited with the Good Business Charter, and TSB's commitment to the prompt payment of suppliers was recognised with the Good Business Pays 'Fast Payer Award' for the third year in a row.
- TSB is a signatory to the United Nation's Net Zero Banking Alliance, committed to aligning its lending and investment portfolios with net-zero emissions by 2050 or sooner.

Financial summary

TSB has reported a statutory profit before tax of £235.5 million in 2023, a 30% increase on the £181.1 million earned in 2022. This reflects solid income growth in an increasing interest rate environment, robust cost management and lower notable costs (summarised on page 7), partially offset by an increase in expected credit loss charges that reflect the more challenging economic outlook.

Customer lending and deposit balances both reduced year on year, by 4.7% and 4.3% respectively, reflecting a selective approach in a challenging UK mortgage lending market, competition in the deposit market, and cost of living pressures. TSB remains well capitalised, with a CET1 ratio of 16.6% (2022: 17.0%) and maintains a healthy liquidity buffer with a Liquidity Coverage Ratio of 203.0% (2022: 195.8%). In light of the Bank's capital strength, strong financial performance in 2023 and robust prospects, following the payment of an inaugural dividend to our shareholder, TSB Banking Group plc, of £67.0 million in December 2022, the Board declared an interim dividend for 2023 of £120.0 million which was paid in December 2023.

Outlook and strategy

In the face of continued economic uncertainty and the prospect of a prolonged period of low economic growth, TSB will remain committed to executing its strategy, simplifying the business to reduce costs, and supporting customers, providing them with solutions that genuinely meet their needs and deliver good outcomes. TSB's focus is firmly on continuing to embed the FCA's Consumer Duty regulations in everything we do for customers. These efforts are squarely aligned with delivering on our purpose – Money Confidence. For everyone. Every day.

Strategic report (continued)

Purpose and business model

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

We believe that TSB's multi-channel proposition creates an opportunity to offer superior service to more of our customers more of the time. They want a bank that offers effortless digital tools to service their banking needs and rapid access to skilled people when they need support.

TSB continues to invest in developing digital-led products and servicing capabilities that help identify and meet more of our customers' needs now and into the future. This, in turn, improves their confidence in managing their money and ensures we live up to our purpose of Money Confidence. For everyone. Every day.

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

Component	Description	Financial statements
Customer confidence	We seek to deliver a proactive, personalised and effortless banking experience for which customers come to, and remain with, TSB. This will increasingly set TSB apart from other banks and providers of financial services. Central to this is our purpose 'Money Confidence. For everyone. Every day.' which focuses investment in our channels and product proposition so customers are rewarded, protected and always in control.	n/a
Sources of funding and capital	Money deposited by customers into their personal current accounts and savings accounts provides the majority of the funds we use to support lending to customers. We also raise funds from other sources, including wholesale markets and central banks, that diversify our funding profile. Our shareholder provides funding in the form of debt and equity capital.	Page 34
Loans and liquid assets	Funds deposited with TSB are used to support lending to customers who wish to borrow. A portion of funds are held in reserve, in the form of a liquidity portfolio, to meet any unexpected funding requirements.	Page 38
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 50
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 His Majesty's Revenue and Customs (HMRC).	Page 52

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

Strategic report (continued)

Review of financial performance

The Bank's performance is presented on a statutory basis, as explained under the basis of preparation on page 28, and structured in a manner consistent with the key elements of the Bank's business model as explained on page 5.

	2023 £ million	2022 £ million
Net interest income	**1,022.0**	981.7
Other income	**134.7**	123.8
Total income (statutory)	**1,156.7**	1,105.5
Income before notable items	**1,133.7**	1,102.8
Notable income (1)	**14.0**	6.6
Banking volatility (2)	**9.0**	(3.9)
Operating expenses (statutory)	**(852.9)**	(869.5)
Operating expenses before notable items	**(798.7)**	(776.3)
Notable expenses (3)	**(52.9)**	(91.2)
Banking volatility (2)	**(1.3)**	(2.0)
Impairment (statutory)	**(68.3)**	(54.9)
Statutory profit before taxation	**235.5**	181.1
Taxation	**(62.1)**	(80.5)
Statutory profit after taxation	**173.4**	100.6

(1) Notable income is further explained under the section called Income below.

(2) Banking volatility in total income comprises of the following line items on the income statement: Gains/(losses) on derivative financial instruments at fair value through profit or loss, (Losses)/gains from hedge accounting, and losses on equity instruments at fair value through profit or loss. Banking volatility in operating expenses reflects volatility associated with share schemes.

(3) Notable expenses are further explained in note 14 on page 54.

TSB's statutory profit before tax for 2023 increased by 30% to £235.5 million (2022: £181.1 million).

Income

Total income increased by 4.6% to £1,156.7 million. Net interest income increased by 4.1% to £1,022.0 million reflecting the effects of the higher interest rate environment and higher deposit net interest margins, partially offset by lower mortgage rates in a highly competitive market. Other income increased by 8.8% to £134.7 million (2022: £123.8 million) due to the recognition of insurance recoveries in respect of migration losses incurred after the 2018 IT migration.

	2023 £ million	2022 £ million
Net interest income	**1,022.0**	981.7
Fee and commission income, net	**108.0**	114.2
Gains on derecognition of financial instruments at FVOCI	**4.3**	6.3
Loss on derecognition of financial liabilities measured at amortised cost	**(1.0)**	–
Other operating income(1)	**0.4**	0.6
Total income before notable items and banking volatility	**1,133.7**	1,102.8
Notable items:	**14.0**	6.6
Migration related items(2)	**14.1**	5.9
Restructuring items(3)	**(0.1)**	0.7
Banking volatility(4)	**9.0**	(3.9)
Total income (statutory)	**1,156.7**	1,105.5

(1) Excludes £14.0 million (2022: £6.6 million) of notable items as described in notes 2 and 3 below and £9.0 million (2022: £(3.9) million) of banking volatility.

(2) Reflects insurance recoveries of £14.1 million (2022: £3.0 million). 2022 also included a further migration related VAT recovery of £2.9 million, which was not repeated in 2023. These items are included in other operating income (as shown in note 13 on page 51).

(3) Comprises of net gains from the disposals of properties and intangible asset write offs, of which £(0.1) million (2022: £0.6 million) is included in (Losses)/gains on derecognition of non-financial assets and liabilities in the income statement on page 31 and £nil (2022: £0.1 million) in Other operating income.

(4) Banking volatility comprises of the following line items on the income statement: Gains/(losses) on derivative financial instruments at fair value through profit or loss, (Losses)/gains from hedge accounting, and Losses on equity instruments at fair value through profit or loss.

Strategic report (continued)

Review of financial performance (continued)

Operating expenses

Operating expenses decreased by 1.9% to £852.9 million (2022: £869.5 million). Despite a period of high inflation, operating expenses before notable items increased only marginally by 2.9% to £798.7 million (2022: £776.3 million). This was driven by employee related costs increasing by 6.7%, reflecting higher annual pay awards. Headcount at the end of the year was however 1.4% lower than at the start of the year. IT servicing and licence costs increased by 7.5% reflecting recent and ongoing investment in IT functionality, improving customer journeys, and fraud protection. These increases were partially offset by lower other expenses reflecting primarily lower conduct costs.

Offsetting the above increase, notable items decreased by 42.0% to £52.9 million (2022: £91.2 million). The key driver for the decrease was the recognition in the prior year of regulatory fines of £48.7 million and conduct charges of £28.6 million. Partially offsetting these items, notable items in 2023 reflected £28.7 million of costs in respect of restructuring activity designed to support the delivery of TSB's strategy and deliver future cost reductions. Notable items in 2023 also included £23.8 million of accelerated charges from a related party IT supplier, where investment by TSB in internal processes to serve customers and improve efficiency led to obsolescence in the supplier's IT equipment, the cost of which was borne by TSB.

Income statement	**2023 £ million**	**2022 £ million**
Operating expenses before notable items and banking volatility	**798.7**	776.3
Notable items[1]:	**52.9**	91.2
Strategic restructuring costs	**28.7**	–
IT servicing and licence costs	**23.8**	–
Migration related items	**(2.7)**	51.1
Conduct charges	**(1.0)**	28.6
Other notable costs	**4.1**	11.5
Banking volatility[2]	**1.3**	2.0
Operating expenses	**852.9**	869.5

(1) Notable operating expenses are further explained in note 14 on page 54.
(2) Banking volatility reflects volatility associated with share schemes.

Impairment

The impairment charge increased in 2023 by £13.4 million to £68.3 million. While the impacts of inflationary pressures were recognised in 2022, there were offsets arising from the full release of COVID-19 related provisions throughout the year. Inflationary pressures and a corresponding fall in house prices continue to be recognised in 2023, without any equivalent offset.

Taxation

The tax charge of £62.1 million (2022: £80.5 million) reflects an effective tax rate of 26.4% (2022: 44.5%), broadly consistent with the applied UK corporation tax rate in 2023 of 27.75%. The difference between the effective and applied tax rates in 2022 was primarily due to conduct charges and regulatory fines that were not deductible for tax purposes, and a £12.3 million reduction in the value of deferred tax assets arising from the substantive enactment in February 2022 of a decrease in the bank surcharge from 8% to 3% that took effect in April 2023.

Strategic report (continued)

Review of financial performance (continued)

Balance sheet, funding and capital

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

	2023 £ million	2022 £ million
Customer deposits	**34,764.3**	36,338.2
Non-customer funding	**7,999.7**	8,119.2
Borrowings from the Bank of England	**4057.9**	5,538.3
Debt securities in issue	**3,664.1**	1,955.5
Repurchase agreements	**–**	360.0
Subordinated liabilities	**277.7**	265.4
Shareholder's equity	**1,954.6**	1,929.8
Sources of funding	**44,718.6**	46,387.2
Other liabilities	**2,934.3**	3,062.4
Total equity and liabilities	**47,652.9**	49,449.6
Loans and advances to customers	**36,245.9**	38,050.0
Liquid asset portfolio(1)	**8,283.0**	7,602.3
Loans and liquid assets	**44,528.9**	45,652.3
Other assets	**3,124.0**	3,797.3
Total assets	**47,652.9**	49,449.6

(1) Comprises balances at central banks of £5,802.2 million (2022: £5,141,2 million) and debt securities of £2,480.8 million (2022: £2,461.1 million). Balances at central banks is included on the consolidated balance sheet in cash, cash balances at central banks and other demand deposits. Analysis is shown in note 32 on page 84.

Source of funding

- *Customer deposits.* Customer deposits decreased by £1.6 billion, or 4.3%, to £34.8 billion, driven by a reduction in retail deposits of £1.3 billion to £32.3 billion. Business banking deposits decreased by £0.3 billion to £2.5 billion. These reductions reflected current account customers moving their deposits to higher interest-earning savings accounts across the market, and higher levels of spend due to cost of living pressures.

- *Non-customer funding.* Non-customer funding decreased by £0.1 billion to £8.0 billion. During 2023, £1.5 billion of borrowings from the Bank of England were repaid, primarily under the Term Funding Scheme with additional incentives for SMEs (TFSME), and balances borrowed under repurchase agreements declined by £0.4 billion. These reductions were largely offset by the issuance of £1.7 billion of debt securities in issue, comprising of the net issuance of £1.5 billion of covered bonds and the issuance of £0.2 billion of unsecured floating rate notes to TSB's parent company, Sabadell, to satisfy MREL requirements.

- *Capital resources*. Shareholder's equity increased by 1.3%, or £24.8 million, primarily reflecting the profit for the year of £173.4 million, partially offset by an interim dividend of £120.0 million paid to TSB's parent, TSB Banking Group plc, in December 2023, and from lower cash flow hedge reserves. 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 16.6% (2022: 17.0%) and a leverage ratio of 4.6% (2022: 4.2%) on a CRD IV fully loaded basis.

Loans and liquid assets

- *Loans and advances to customers*. Loans and advances to customers decreased by £1.8 billion, or 4.7%, to £36.2 billion reflecting the challenging UK mortgage lending market, where gross lending was approximately 30% lower than in 2022. Higher interest rates are constraining overall housing transactions and, with strong competition in the market, customers are shopping around for the best deal to mitigate the impact of rising mortgage costs.

- *Liquid asset portfolio*. TSB's liquidity portfolio comprises highly liquid assets, primarily balances deposited at the Bank of England, UK gilts, development bank bonds, and covered bonds, which are available and accessible to meet potential cash outflows. During 2023, the liquidity portfolio increased by £0.7 billion to £8.3 billion, reflecting an increase in balances on deposit with the Bank of England.

Strategic report (continued)

Principal risks and uncertainties

Approach to risk

TSB seeks to remain liquid, solvent, operationally stable, trusted, and compliant at all times. The objective of TSB risk management is to support and enable these outcomes. The processes to identify, measure and control the risks inherent in its business model are embedded in TSB's risk management framework. TSB's approach to managing these risks is described below. TSB's principal risks and uncertainties are described starting on page 11.

Risk management framework

The risk management framework is designed to promote an effective risk culture, by providing clear processes and approaches that help TSB manage its risks in an effective and consistent way. 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 seven level 1 risk categories which may impact on day-to-day activities across TSB are shown in the table below.

Strategic risk	The risk arising from an inadequate strategy, unsuccessful execution of the strategy or not responding to changes in the socio or macro-economic environment.
Model risk	The risk that models used to manage the business are inadequate, are used inappropriately, or perform ineffectively.
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 borrower or counterparty fails to pay the interest or to repay the principal on a loan or other financial instrument as it falls due.
Operational risk & resilience	The risk of loss, damage or disruption to TSB's resilience and both 'Important' and 'Other' Business Services we provide to our customers, arising from inadequate or failed internal processes, people or systems.
Conduct risk	The risk that TSB fails to act to deliver good outcomes for its customers, or the risk 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. TSB's risk management framework sets out the essential principles and practices that everyone must follow. This enables a clear understanding and separation between functions that own and manage risks faced by the business (first line), provides oversight and challenge (second line), and provides independent audit and assurance (third line).

First line of defence	Responsible for the implementation and execution of the risk management framework to meet all applicable legal, regulatory and mandatory requirements, through the identification, assessment and management of risks, controls, events and policy.
Second line of defence	Responsible for the design, maintenance and monitoring of the risk management framework including risk appetite and the alignment to regulations. Provide independent validation and challenge on first line's identification, assessment and management of risks and controls, to support adherence to policy and legal and regulatory requirements.
Third line of defence	Responsible for providing independent assurance on the effectiveness of risk management, controls and governance in the first and second lines.

Risk culture

TSB's culture is monitored by the Executive Committee and Board to promote the right behaviours to support Money Confidence, For everyone, Every day, in line with our strategy.

The TSB risk management framework consists of a set of principles and practices designed to comply with all relevant laws and regulations to demonstrate safe control of all risks. This lends to the promotion of a risk aware, customer focused culture to support the provision of products and services which provide good customer outcomes.

The key behaviours underpinning TSB's risk culture include integrity, individual responsibility, an open attitude to questions and providing challenge, and effective communication ensuring common understanding and instilling confidence. TSB's culture is reinforced by the approach to performance management and remuneration for all employees. Our aim is for both our employees and our customers to experience the benefits of a high performing culture, supported by a clear customer focus where employees feel confident that good customer outcomes are achieved at all times.

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 which, through regular meetings and reporting, monitors performance against appetite and ensures appropriate remedial action is taken to address any appetite breaches.

TSB has a clearly defined and proportionate risk appetite that supports its strategy and seeks to provide confidence to its customers, regulators and shareholder.

TSB'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 are 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.

Risk governance
Risk ownership and accountability sits with individuals, supported by governance and reporting via TSB's risk committees. Each committee is responsible for monitoring TSB's risk profile and challenging risk exposures across the relevant risk category in line with the risk appetite set by the Board.

This committee structure enables efficient decision making, providing clear escalation and reporting of risk to Executive and Board Risk Committees, and to the Board which is responsible for providing oversight of the effectiveness of the risk management framework. TSB's risk committee structure covers each of the Level 1 risk categories, with the exception of strategic risk, which is discussed at Executive and Board Risk Committees, to provide a dedicated focus on managing those risks. Progress is assessed monthly through the Chief Executive's report to the Board.

A significant change in the committee structure in September 2023 has been the introduction of a Non-Financial Risk Committee chaired by the Chief Risk Officer. This Committee replaces the Operational Risk and Resilience Committee, Conduct Risk Committee and Financial Crime Risk Committee. It provides the opportunity to focus on material aggregated issues, themes and matters escalated by first line business units with input from oversight teams and specialists accountable to the risk.

Asset & Liability Committee (financial risk)
Chaired by the Chief Financial Officer, the committee is responsible for the strategic management of TSB's balance sheet, the profit and loss implications of balance sheet management actions and the risk management framework for market risk, liquidity risk, capital risk, economic value and financial and prudential regulatory reporting risk.
Credit Risk Committee (credit risk)
Chaired by the Credit Risk Director, 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.
Non-Financial Risk Committee (conduct risk, operational risk and resilience and financial crime risk)
Chaired by the Chief Risk Officer, the committee is responsible for the identification, assessment, management and reporting of non-financial risks (conduct, operational risk and resilience, and financial crime) across TSB.
Model Governance Committee (model risk)
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 and acting as the Designated Committee as required by the Capital Requirements Regulation.

The TSB policy framework is a key component of the overarching risk management framework. It comprises all formal bank policies with the exception of those owned by Human Resources, and the supporting procedures/guidelines used to manage and govern these policies.

The policy framework supports the management and oversight of TSB's risks. All policies are subject to annual review and approval through an agreed governance route. The policy owner is accountable for defining the controls required to mitigate the relevant risks, compliance and approving waivers or breaches. Management information on the operation and application of the policy framework is reported through the Bank's risk governance as part of the overarching risk management framework and is therefore subject to the accountabilities outlined in the lines of defence model on page 9.

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 TSB's strategy. Over the course of 2023 there has been a continued focus on the impact on macro-economic conditions contributing to rates of inflation remaining above Bank of England targets throughout 2023. It is expected that high inflation and interest rates will continue to contribute to pressures on costs of living for our customers during 2024.

The Bank closely monitors customer activity across all portfolios through a host of key performance metrics, using both internal and externally sourced data. Despite the ongoing challenging economic environment and the impact on customers from cost of living pressures, all portfolios continue to perform well, with minimal signs of stress being evidenced. Whilst increases in levels of arrears have been noted, this is from a low base and remains below industry average. We continue to provide support to our customers through our mission to deliver Money Confidence. For everyone. Every day. Additionally, our Consumer Duty programme has delivered a series of enhancements to our customer propositions and servicing.

Update to principal risks from 2022

Over the course of 2023 our principal risks and uncertainties have evolved from those reported in the 2022 Annual Report. This has resulted in an increased focus on the risk of supplier failure in view of wider economic conditions. Likewise, it is recognised that in today's society data management plays an increasingly important role to ensure our customers continue to receive products and a level of service they can reasonably expect.

New principal risks in 2023

Description	Mitigation
Global macro-economic impact on strategy execution	
The continued global geopolitical and macroeconomic uncertainty could impact on the delivery of TSB's strategy and financial stability. There is a risk this may lead to further macro-economic pressures, increased levels of sanction activity or threat of cyber-attack by nation sates leading to further challenges to customer confidence or a negative impact on TSB's strategy, profitability, capital funding or liquidity requirements.	The Board and Executive regularly review progress against the medium term plan and a suite of risk appetite measures across our risk categories. We perform horizon scanning to monitor for new threats and issues that require TSB to respond or adjust its risk appetite. We have reviewed and set our credit risk appetite and policies to respond to the challenges faced by our customers. Our capital, funding and liquidity requirements continue to be proactively monitored and subject to severe but plausible scenario stress testing to ensure TSB meets its commitments and make funding adjustments where required.
Execution of technology strategy	
The successful execution of the technology strategy fails to provide the appropriate levels of technology resilience or availability, or effective implementation of change to support the delivery of TSB's overall strategy.	The delivery of the technology strategy is being coordinated by a Transformation Management Office and is subject to rigorous programme governance, measurement and reporting. The second line provides oversight with assurance provided by the third line.

Risks reported in 2022 which continue to be relevant

Description	Mitigation
Data management	
Data critical to servicing customer needs, managing risk and meeting regulatory reporting expectations is not sufficiently understood or protected, or of appropriate quality, leading to loss of data, customer harm or regulatory censure.	A data strategy has been developed which identifies the foundational data management components that need to be improved. The Data Governance Executive Council has been established and provides first line oversight of the material data risks.
Supplier failure	
Economic conditions increase the risk of critical supplier failure or severe degradation of service delivery, leading to customer service impacts, customer harm, financial loss and regulatory censure.	A supplier management framework is in place, with increased scrutiny of critical suppliers. Through the Operational Resilience programme, suppliers critical to important business services are mapped and understood. Plans to exit arrangements with key suppliers, and where necessary utilise alternative suppliers, are documented and reviewed.

Strategic report (continued)

Principal risks and uncertainties (continued)

Risks reported in 2022 which continue to be relevant (continued)

Description	Mitigation
Cost of living	
The outlook for the UK economy remains uncertain, impacting on customer affordability. This has led to a cost of living challenge across the UK, with implications for affordability and customer confidence to take on additional borrowing. A sustained challenge could lead to further threats to TSB's strategy and have a negative impact on profitability, capital, funding and liquidity requirements.	TSB has strengthened its support for customers in financial difficulty by mobilising a multi-disciplinary team to support our Money Confidence purpose. This team is responsible for TSB's response to the cost of living challenge faced by customers; monitoring credit affordability to support sustainable lending, and continued improvement in the management of pre-arrears and the provision of customer support measures. TSB has signed up to the UK government's Mortgage Charter for residential mortgage lending to provide support to customers and extended similar support to buy-to-let customers. All lending portfolios continue to be monitored against agreed risk appetite metrics. Risk appetite in 2024 has been set to reflect the continued uncertain economic outlook in the UK. Our capital, funding and liquidity requirements will continue to be proactively managed to ensure TSB is able to meet its requirements.
Customer harm	
Delivering good customer outcomes and preventing foreseeable customer harm is a key focus. This risk continues to evolve to reflect economic conditions, an ever-changing digital landscape, increased complexity of supplier relationships, and increasing societal and regulatory expectations. For example: • The current economic conditions are likely to lead to changes in customer behaviour and have implications for lending affordability. This will require continued focus on the provision of effective processes and use of data and technology to prevent customer harm. • TSB's implementation of the Consumer Duty regulation seeks to address and prevent foreseeable harm and requires that products and services are fit for purpose and relevant information can be accessed effectively by consumers.	The risk management framework has continued to be refined over the course of 2023 and reflects Consumer Duty requirements. The Executive Committee receives a range of data on customer outcomes. This includes a monthly conduct dashboard which is provided to the Board. Following the implementation of Consumer Duty, management information has been further enhanced to provide deeper insight on customer outcomes and to support identification of customer harm. Where this is identified, action plans are put in place to rectify the situation or improve the customer journey, as appropriate. Colleague training continues to develop to reflect regulatory and cultural change and support our purpose of Money Confidence.
Maintaining technical and operational resilience	
The ability to maintain digital services is key to our customers and regulators and presents a range of risks including disruption to business activities from cyber-attack, inadequate infrastructure, poor supplier service, and ineffective technology resilience and operational processing.	In 2023 we continued to embed our operational resilience framework. This supports the identification, mapping, and assessment of important business services, enabling identification and remediation of areas where the risk of adverse operational resilience is heightened. Managing cyber risk requires constant focus for TSB. A new cyber security strategy was defined in the second half of 2023 and will be embedded in 2024 to further enhance the strong cyber controls.

Strategic report (continued)

Principal risks and uncertainties (continued)

Risks reported in 2022 which continue to be relevant (continued)

Description	Mitigation
Economic crime (previously fraud risk)	
There are two key risks which are actively under management: 1. The risk that TSB fails to protect its customers from becoming victims of fraudulent activity caused by internal or external parties, leading to financial loss, regulatory censure, reputational damage or customer harm. 2. The risk that TSB fails to identify and prevent financial crime through inadequate compliance or interpretation of relevant laws and regulations.	In 2023 the economic crime risk framework was strengthened. There is ongoing focus on sanctions screening, country and customer risk assessments and business risk appetite to manage TSB's exposure to the higher risk jurisdictions. Readiness work has commenced ahead of new rules from the Payment Systems Regulator due in 2024 around authorised push payment fraud.
Climate change	
Risks relating to climate change include physical threats, transitional risks, failure to meet our reduction targets, and the potential for poor customer outcomes. As TSB's lending portfolio is predominantly comprised of mortgage assets, the main physical risks are flooding, subsidence and coastal erosion risks associated with the property related collateral that underpins this 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 costs of improving property energy ratings.	The Planet Steering Committee, established as part of TSB's Do What Matters Plan, oversees the ongoing management of the financial risks from climate change, provides direction on regulatory expectations and considers industry best practice. The steps taken to address the risks and opportunities presented by climate change are more fully documented on page 19. Mitigants to the risks associated with TSB's mortgage portfolio are monitored through climate related risk appetite measures, insurance assessments, and scenario analysis.
Attract and retain talent in a competitive market	
A highly competitive employment market, particularly in a number of specialist fields, continues to provide challenges in recruiting and retaining talent.	TSB encourages a diverse and welcoming workplace to reflect the customers and communities it serves across the UK. As outlined in our Do What Matters Plan, TSB seeks to be a trusted employer and to drive performance in a sustainable manner. TSB continues to assess and prioritise any skills gaps, creating an engaging and rewarding experience for our colleagues, while providing opportunities to develop new relevant skills to support our strategic direction.

Strategic report (continued)

Principal risks and uncertainties (continued)

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

Emerging risks reported in 2022 that continue to be relevant

Title	Description	Mitigation
Greater divergence in regulations and/or supervisory approach	In addition to UK regulation, TSB is subject to EU regulations and supervisory approaches through its parent, Sabadell. Conflicting requirements may lead to operational challenges or increased costs.	TSB actively seeks to manage cross-border compliance risks through effective co-ordination with Sabadell, regular regulatory horizon scanning, appropriate prioritisation of legal, regulatory and mandatory change, and a transparent and pro-active relationship with regulators.

New emerging risks

Title	Description	Mitigation
Artificial intelligence (AI)	There are opportunities to improve banking services for our customers in innovative and cost-efficient ways. Conversely, in the wrong hands, AI has the capability to negatively impact customer confidence in the banking system and increase fraud or operational losses caused by disruption through intrusive cyber-attacks by organised crime or nation states.	The development of secure AI systems through additional governance and vigorous testing, and specific techniques to ensure transparency of the build and deployment of AI tools.
Societal polarisation	Continued inflation may exacerbate income inequality, heightening cost of living and affordability concerns, resulting in credit losses and increasingly complex customer financial needs. Additionally, there may be a perception of injustice which could lead to increased fraud, financial crime or cyber attacks.	TSB continues to monitor the level of credit provisions and operational costs related to providing support to our customers. Additionally, TSB's fraud strategy will be reviewed and further mitigation undertaken following cyber risk threat assessments.
Expansion of use of cloud services	TSB utilises cloud services, however, as the extent of this expands it is recognised that it may lead to an over dependence on a small group of global suppliers capable of providing the scale of service required.	The Chief Information Office monitors the delivery of the IT strategy, including the target operating model for the provision of cloud services.

Strategic report (continued)

TSB's Do What Matters Plan
The Do What Matters 2025 plan is an integral part of our business strategy. It brings together our social and environmental commitments to deliver long lasting and meaningful impact for our customers, colleagues, suppliers and communities.

The plan is simple and focused on three key areas: **essentials, people,** and **planet,** which are connected clearly to our purpose – Money Confidence. For everyone. Every day.

The plan has eight long term goals centred around the themes of social and financial inclusion, fair business practices, and supporting a just transition to a greener planet.

Let's do what's right for people

Customers
Nurture financial resilience and support for tough times

Colleagues
Continue building a representative workforce where colleagues can thrive

Communities
Work to improve money confidence in local communities

Suppliers
Promote fair business and shared values

Let's do what's right for the planet

Customers
Help customers play their part in tackling climate change

Colleagues
Empower workforce to improve sustainability

Communities
Support local activity to drive sustainability

Suppliers
Partner to drive sustainability through the supply chain

<u>Essentials</u>

Governing the plan
The Board provides strategic direction on the Bank's approach to the Do What Matters Plan, including how we manage the financial risks of climate change. They receive an annual update on the Do What Matters Plan and periodic updates are also provided to the Risk Committee on climate risk.

The Executive Committee discusses progress of the Do What Matters Plan on a quarterly basis. This incorporates recommendations and progress reported by the Planet Steering Committee and the People Working Group.

The Chief Risk Officer and Chief Financial Officer have a shared responsibility for identifying and managing the financial risks from climate change. This includes embedding of climate change risk within the risk management framework, developing scenario analysis, and managing the financial risks from climate change.

Aligning to independent standards and commitments
We continue to be a signatory to the UN Global Compact corporate responsibility initiative, aligning the way we operate with ten universally accepted principles in the areas of human rights, labour, environment, and anticorruption, and to take action in support of UN Sustainable Development Goals.

We are also accredited by the Good Business Charter, a UK scheme that recognises businesses that behave responsibly across ten areas including paying the living wage and not offering zero hours contracts, paying suppliers promptly, promoting diversity and inclusion, ensuring the employee voice is heard in the boardroom and setting firm plans to reach net zero.

Meeting regulatory and voluntary codes of practice
We have policies and processes in place to make sure we meet regulatory obligations and voluntary codes of practice. Collectively they set out the high standards we operate to protect our customers, colleagues and communities from the impacts of criminal activity, and continue to meet the changing needs of our customers.

Strategic report (continued)

TSB's Do What Matters Plan (continued)

Non-financial and sustainability information statement

As a public interest entity, TSB complies with the non-financial and sustainability reporting requirements of sections 414CA and 414CB of the Companies Act 2006 as summarised in the table below.

Section	Area	Description	References and policies
People	**Community and social matters (page 16)**	We're focused on delivering social good which means supporting financial and social inclusion and encouraging fair business practices.	Our approach to communities and social matters on pages 16 and 17. • Fraud policy • Vulnerable customers policy
	Colleagues (page 17)	We believe everyone has a right to work in a safe and supportive environment, where all colleagues act responsibly. We continue to build a workforce that is representative of our customers and the communities we operate in.	Our approach to colleagues on pages 17 and 18. • Code of conduct • Employment policy • Health, safety and fire policy • Inclusion policy • Remuneration policy
	Respect for human rights (page 18)	We're committed to preventing modern slavery and human trafficking in our corporate activities. Our Modern Slavery statement outlines the steps we're taking to understand associated risks related to our business and our supply chains.	Our approach to respect for human rights on page 18. • Modern slavery statement • Responsible supplier charter
	Financial crime, anti-bribery and corruption (page 18)	We have a moral, legal and regulatory duty to prevent, detect and deter economic crime. We care about our customers and colleagues, and the communities we serve, and strive to protect them from those who would try to use TSB to commit economic crimes.	Our approach to tackling financial crime, anti-bribery and corruption on page 18. • Anti-bribery and corruption policy • Anti-money laundering and counter terrorist financing policy • Sanctions policy • Whistleblowing policy
Planet	**Planet (page 19)**	Doing what matters for the planet is an increasingly important consideration for our customers, colleagues and other stakeholders we work with, including regulators.	Our approach to the planet on pages 19 to 23. • Doing What Matters for the Planet - policy

<u>People</u>

Community and social matters

We deliver social good connected to our purpose by focusing on those people in our communities who are least likely to have confidence with their money and are most at risk of being financially excluded.

It is our duty to protect our customers who are vulnerable and provide them with support tailored to their specific needs. Our vulnerable customer policy guides us on how to identify vulnerability and respond to it in the right way.

We have continued to meet our commitment to refund every TSB customer who is an innocent victim of fraud. In 2023, TSB refunded 97% (2022: 97%) of all fraud cases compared with an industry wide refund rate of only 64% (2022: 56%).

TSB has taken a leading position in supporting victim-survivors of domestic abuse. We provide a safe space in all our branches and online, and during 2023 we helped around 200 customers escape an abusive relationship with money from our award-winning Emergency Flee Fund. Insight from this activity has helped inform both the Scottish and Westminster governments to implement their own 'flee fund'. In September 2023, we received an 'Every One's Business Award' from the Employer's Initiative on Domestic Abuse recognising the support we offer colleagues who experience domestic abuse.

Small businesses face significant cashflow challenges in the current economic climate. As a signatory of the Prompt Payment Code, a government-backed voluntary code of practice, we paid 99% (2022: 98%) of all suppliers within 30 days. We also prioritise our small and medium sized suppliers and paid them in an average of 4 days (2022: 4 days). In recognition of our ability to pay suppliers promptly, TSB received the Good Business Pays 'Fast Payer Award' for our prompt payment of suppliers in 2021, 2022 and 2023.

We also help our small business customers to get paid quickly too. Our partnership with Revenu supports our business customers to receive quicker, more convenient payments from their customers.

Strategic report (continued)

TSB's Do What Matters Plan (continued)

People (continued)

Our key community and social matters' policies

Policy	Summary
Fraud policy	This policy provides a framework to manage the risk of fraud and to protect TSB and its customers. The policy sets out the minimum requirements to adhere to, ensuring that there are controls in place to manage fraud risk effectively within approved risk appetite.
Vulnerable customer policy	This policy sets out the minimum requirements for our colleagues, business areas and relevant third parties to identify and treat our vulnerable customers appropriately. A regular review of customer journeys and outcome testing is undertaken, and colleagues must undertake periodic core learning to ensure that the policy requirements are embedded throughout the Bank.

Colleagues
We are building an inclusive culture, where everyone belongs and is valued for the differences they bring. We know that this diversity will help us to better support our customers at the moments that matter most to them.

Our Inclusion strategy sets out representation goals we'll deliver by 2025, underpinned by our Inclusion policy. We continue to make good progress towards our representation goals and increasing the number of colleagues who feel comfortable sharing their diversity data with us. In our 2023 Colleague Engagement Survey, 93% of colleagues agreed that TSB promotes an inclusive work environment that accepts everyone's individual differences. As of the end of 2023:

- 42% (2022: 42%) of our senior leaders are women, above the UK banking industry average of 39%;
- 5% (2022: 6%) of colleagues identify as lesbian, gay or bi-sexual(1) compared to 3% of the UK workforce;
- 18% (2022: 20%) of colleagues disclose a disability(1) compared to 19% of the UK workforce;
- 16% (2022: 12%) of colleagues and 12% (2022: 9.5%) of our senior leaders are Black, Asian and minority ethnic; and
- 2.5% (2022: 1.8%) of colleagues and 2.2% (2022: 1.2%) of senior leaders are Black.

(1) Percentages reflect the proportion of colleagues who volunteered relevant diversity data. Year on year comparison reflects increased colleague data.

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. In 2023 we completed an audit of our people services for disabled colleagues and have defined an action plan to continue to improve that experience.

We have embedded new inclusive policies to enable more of our colleagues to reach their potential. Examples include our equal parental leave policy which gives colleagues, regardless of their route to becoming a parent or their parental role, the same parental leave of up to 1 year with the first 20 weeks paid. Our carers leave policy, which provides up to 70 hours paid leave each year, supports colleagues with managing caring responsibilities together with work.

We continue to support an intersectional Inclusion network with sponsorship from members of the Executive Committee for TSB Ability, Ethnicity, Gender Inclusion, LGBTQ+ and Social Mobility. These networks actively educate and challenge us while contributing to diversity and inclusion plans.

TSB encourages collaborative and honest dialogue at all levels as follows:

- TSB's annual colleague experience survey provides employees with the opportunity to feedback on working at TSB, with a roadmap developed to address the key findings.
- 83% of colleagues in the 2023 engagement survey said that constructive challenge is valued where they work.
- TSB's employee forum, The Link, set up in 2014, met 12 times in 2023, providing a direct connection between employees, the executive leadership, and the TSB Board.
- Two-way communications channels enable colleagues to stay connected to TSB's strategy and purpose and to discuss performance against collective aims.

We also continue to work closely with our recognised unions, Accord and Unite, on key focus areas including financial support and wellbeing, total reward and pay, inclusive policies and organisational change and redeployment.

Strategic report (continued)

TSB's Do What Matters Plan (continued)

People (continued)

Our key colleague policies

Policy	Summary
Employment policy	This policy outlines our approach to performance, ways of working, and attracting, retaining and engaging a diversity of talented people. This policy also focuses on people risk and people data management and controls. It ensures we comply with relevant employment legislation and regulatory requirements to minimise employment litigation and reputational damage and the behavioural standards which colleagues must act within.
Inclusion policy	This policy outlines our commitment to fostering an inclusive culture which embraces difference, where everyone feels included and welcome, treated with dignity and respect, regardless of their identity, background, or other circumstances.
Code of conduct	Our code of conduct underpins our purpose and guides how we work with colleagues and customers. It supports our behaviours: saying it straight, feeling what customers feel, looking for better and doing what matters.
Health, safety and fire policy	Our high-level approach to health and safety to protect our colleagues and visitors to our offices and customers across our branch network.
Renumeration policy	This policy sets out our approach to remuneration with the aim of making sure TSB can attract, motivate and retain the people needed to deliver our strategy. The policy is governed and reviewed annually by the Renumeration Committee.

These policies are part of the risk management framework. Under the health, safety and fire policy, all new joiners and every year thereafter complete mandatory learning. The learning covers emergency procedures, accident reporting, first aid, fire evacuations and lone working safety. We have trained first aiders and fire marshals working in our offices.

Respect for human rights
TSB's modern slavery statement sets out the policies we apply and actions we take to ensure that our colleagues and customers are treated with dignity and respect.

Financial crime, anti-bribery and corruption
Our financial crime framework aims to protect our customers, employees and communities from financial crime, and we continue to invest in further system control enhancements.

Our financial crime, anti-bribery and corruption policies are as follows:

Policies	Summary
Anti-bribery and corruption policy	This policy and supporting technical standards provide the framework to support TSB, its colleagues and all other 'associated persons' in complying with relevant legislation and in particular, the Bribery Act 2010 and the Criminal Finances Act 2017.
Anti-money laundering and counter terrorist financing policy	This policy enshrines TSB's commitment to the fight against money laundering and terrorist financing, operating in an open and co-operative manner with regulators and seeking to ensure strict adherence to applicable legislation and regulations.
Sanctions policy	This policy and supporting technical standards are designed to ensure compliance with our obligations under the United Nations and UK sanctions regimes. TSB takes a prohibitive stance towards transactions and customer relationships involved in countries subject to comprehensive international sanctions or which are owned or controlled by persons located in such countries.
Whistleblowing policy	This policy provides the framework to support TSB and its colleagues in compliance with the Public Interest Disclosure Act 1998 (PIDA) and Financial Conduct Authority's SYSC Chapter 18 rules on Whistleblowing.

Economic crime is a principal risk as further described on page 13 and the above policies are embedded in TSB via the risk management framework.

Strategic report (continued)

TSB's Do What Matters Plan (continued)

Planet

We are focused on reducing our impact on the environment, meeting the highest international standards, and supporting those we serve and do business with to make sustainable decisions. We have set ambitious targets to reduce the amount of waste and emissions we produce. In 2021, we set our pathway to net-zero which committed TSB to being operationally net-zero by 2030 and net-zero in our financed emissions by 2050.

	Own operational emissions: Net-zero by 2030						Financed emissions: Net-zero by 2050		
	Scope 1	Scope 2	Scope 3				Scope 3 (Category 15)		
Greenhouse Gas Protocol Category	Emissions from heating and cooling our estate	Indirect emissions from heating and cooling our estate	Waste	Business travel	Water & paper	Employee commuting & home working	Mortgages	Corporate real estate loans	Business loans

Over the past year we've continued to reduce our own operational emissions, set targets for our financed emissions, and prioritised the right actions to deliver our climate commitments.

TSB's Doing What Matters for the Planet policy sets out our approach to reducing our impact on the environment and guides our activities. The operation of this policy follows our risk management framework and includes oversight and assurance over controls.

Managing the risks associated with climate change

We continue to consider the risks and opportunities associated with climate change and these are incorporated in TSB's medium term plan. We have used our established risk management framework to assess the significance of the climate-related risks facing TSB, for example:

- In 2023, we introduced a new Level 1 strategic risk category which includes an ESG risk category. This focuses on the risks arising from environmental, social and governance issues, making climate change risk more visible within TSB's risk management framework as outlined on page 9;
- We have considered climate change within our annual risk appetite review; and
- We have assessed and documented how climate change may influence each of the policies within the TSB policy framework as part of the policy effectiveness statement.

Risks and opportunities

TSB's assessment of the materiality of climate change includes the climate impact on TSB (financial materiality) and TSB's impact on the climate (environmental and social materiality). The exercise also included a qualitative impact assessment of climate scenarios, considering potential risks, mitigants and opportunities across all high or medium impacted risk categories. This used the Climate Biennial Exploratory Scenarios, issued by the Bank of England, as a guideline.

This qualitative analysis is complementary to the quantitative analysis of the residential mortgage portfolio covered below, helping to provide a comprehensive view of potential risks and impacts across a range of potential climate pathways. With TSB's lending portfolio predominantly comprised of mortgage assets, the risks from climate change arise in two main ways, physical risk and transition risk.

- *Physical risk*: The main physical risks for TSB in the medium and long term (mid to late 2030s and beyond) relate to flooding, precipitation, subsidence, and coastal erosion impacting the potential realisable value of property related collateral. Of these, flooding and precipitation pose the primary physical risk to TSB. We have measured subsidence and coastal erosion risks and due to low exposure rates concluded these are not a principal concern.

- *Transition risk*: The main transition risks arise from the poor energy efficiency of properties against which TSB's mortgage lending is secured and the cost of improving property energy ratings. Such risks cover both short term (to 2030) and medium and long term horizons. There is an emerging risk associated with both changing consumer and investor demand for more energy efficient properties, and the potential loss in marketability and market value of poorer energy performing properties.

While TSB is not materially affected by climate risk in the short term and financial exposure is low, we are impact assessing physical risks for new mortgage lending. This enables us to identify exposures in the context of our defined risk appetite. From a transition perspective, we continue to experience improvements in the average energy performance certificate (EPC) Standard Assessment Procedure (SAP) score of our existing mortgage loans, as shown in the table on the next page. SAP is the methodology used by the UK government to assess and compare energy and environmental performance of residential properties.

TSB's Do What Matters Plan (continued)

Planet (continued)

Risks and opportunities (continued)

Year*	Average EPC score	Average SAP score
2019	D	62.6
2021	D	63.5
2023	D	64.8

*The analysis was not performed in respect of 2020 and 2022.

We monitor and comply with evolving regulations around climate change and, in the meantime, we deliver awareness campaigns and tools that build our customers' understanding of the opportunities to improve the energy efficiency of their homes and the use of low-carbon heating technologies.

Scenario analysis
We use scenario analysis to help identify and measure climate-related risks, and to make sure their management and mitigation are embedded in our strategy, risk appetite, financial planning and capital management processes as they become more material over time.

TSB developed its scenario analysis capability during 2022 to assess the financial impacts of climate change risks on the residential mortgage portfolio. We delivered the approach in line with guidance in the Bank of England's Climate Biennial Exploratory Scenarios which reflected three climate scenarios - early policy action (where transition to a carbon-neutral economy starts early), late policy action (where transition to a carbon-neutral economy is delayed until 2030), and no additional action (where climate targets are missed and physical risks are more severe).

The results showed that TSB is at the lower end of industry estimates for forecast credit losses and concluded that climate risks do not materially affect its capital position in the current planning horizon.

Own operational emissions: Metrics

Methodology
Greenhouse gas emissions continue to be reported in line with the UK Streamlined Energy and Carbon Reporting (SECR) requirements. Data has been compiled following the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard.

Assurance
TSB appointed Ernst and Young LLP (EY) to provide independent limited assurance over the 2023 metrics, being those indicated in Tables 1 and 2 below by (*). The assurance engagement was planned and performed in accordance with the International Standard for Assurance Engagement (ISAE) (UK) 3000 (July 2020) Assurance Engagements Other than Audits or Reviews of Historical Financial Information.

A limited assurance report was issued and is available at https://www.tsb.co.uk/files/tsb_2023_assurance_report.pdf. This report contains details of the scope, respective responsibilities, work performed, limitations and conclusion. Further information on TSB's methodology and full Summary of Streamlined Energy and Carbon Reporting can be found at https://www.tsb.co.uk/files/tsb-secr-methodology-2023.pdf.

Location-based emissions
As shown in the table below, TSB's total energy consumption, as measured on a location[1] basis, was marginally lower in 2023 compared to 2022.

Table 1: Summary of Streamlined Energy and Carbon Reporting	2023	2022	2021	2020	2019
Location-based[1] emissions in gross tonnes of carbon dioxide equivalent (tCO2e)[2]					
Scope 1 emissions from the combustion of fuel and operation of facilities [3]	**1,410***	1,669*	2,171	2,761	3,010
Scope 2 emissions from the purchase of electricity[4]	**2,701***	2,958*	4,267	5,561	7,139
Total scope 1 and 2 location-based emissions	**4,111***	4,627*	6,438	8,322	10,149
Scope 3 emissions from business travel, waste, water and paper	**1,383***	925*	745	1,509	3,330
Total Scope 1, 2 and 3 location-based emissions	**5,494***	5,552*	7,183	9,831	13,479
Intensity ratio (location-based tCO2e per FTE)[5]	**1.0***	1.0*	1.2	1.4	1.8
Energy consumption kWh (million)[6]	**20.749***	23.844*	31.378	39.310	43.720

Foot notes are shown under the tables on the following page.

Strategic report (continued)

TSB's Do What Matters Plan (continued)

Planet (continued)

Own operational emission: Metrics (continued)

Location-based emissions (continued)
In line with TSB re-baselining policy, we have also created a re-baselined view of 2019 to 2022 locations emissions data (Table 2), which provides an adjusted view to account for site closures and FTE reductions during this period. See Summary of Streamlined Energy and Carbon Reporting methodology paper at https://www.tsb.co.uk/files/tsb-secr-methodology-2023.pdf for a full description of how the re-baselining was applied.

		Re-baselined			
Table 2: Re-baselined Summary of Streamlined Energy and Carbon Reporting	**2023**	**2022**	**2021**	**2020**	**2019**
Location-based [1] emissions in gross tonnes of carbon dioxide equivalent (tCO2e)[2]					
Scope 1 emissions from the combustion of fuel and operation of facilities [3]	**1,410***	1,542	1,679	1,763	1,799
Scope 2 emissions from the purchase of electricity [4]	**2,701***	2,509	3,366	3,507	4,554
Total scope 1 and 2 location-based emissions	**4,111***	4,051	5,045	5,270	6,353
Scope 3 emissions from business travel, waste, water and paper	**1,383***	1,089	932	1,435	3,014
Total Scope 1, 2 and 3 location-based emissions	**5,494***	5,140	5,977	6,705	9,367
Energy consumption kWh (million) [6]	**20.749***	21.591	25.326	24.516	27.398

Market-based emissions

Table 3: Summary of Streamlined Energy and Carbon Reporting	**2023**	**2022**	**2021**	**2020**	**2019**
Scopes 1 and 2 market-based[7] emissions in gross tonnes of carbon dioxide equivalent (tCO_2e)[8]	**1,410**	1,669	2,171	2,761	8,284
Verified carbon removals (offsets)[9]	**(1,410)**	(1,669)	(2,171)	(2,761)	–
Net scope 1 and 2 market-based emissions[10]	–	–	–	–	8,284
Total scope 1, 2 and 3 market-based emissions	**1,383**	925	745	1,509	11,614

Resource consumption data					
Paper (tonnage)[11]	**491**	445	583	984	1,439
Water (m^3)	**37,760**	39,289	47,238	67,409	86,469
Waste (tonnage)[12]	**557**	839	1,200	1,452	1,036
Waste diverted from landfill	**99.3%**	99.6%	99.7%	99.4%	97.1%
Waste intensity (waste tonnage per FTE)[13]	**0.10**	0.15	0.20	0.21	0.17

Notes to Tables 1, 2 and 3
(1) Location-based emissions are those measured using the UK national grid electricity conversion factors, updated annually.
(2) tCO2e – tonnes of carbon dioxide equivalent.
(3) Scope 1: gas, heating oil, fugitive gas and company cars.
(4) Scope 2: 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.
(7) 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.
(8) Scope 1 and 2 emissions: Natural gas, fugitive gas, heating oil, company cars, electricity (100% REGO certified).
(9) Plan Vivo carbon removal certificates registered on the Markit Environmental Registry.
(10) Net Scope 1 and 2 emissions are total market-based emissions minus verified carbon removals.
(11) Paper: Total tonnage arising from office and branch paper purchases, print and mail and marketing activities.
(12) Waste: Total tonnage arising from office and branch waste, destruction of archived documents, recycling of IT equipment and project waste including activity from branch closures.
(13) Calculated as the tonnes of waste generated divided by the average annual headcount.

In 2023, Scope 1 and 2 market based emissions reduced by 83% compared to 2019 to 1,410 tonnes of carbon dioxide equivalent (tCO2e). Scope 3 emissions reduced by 54% compared to 2019. These reductions were due to energy optimisation measures, site closures, and positive colleague action on energy efficiency and waste.

TSB completed the second phase of its energy optimisation programme, which has contributed to a reduction in location-based energy consumption from gas, oil and electricity by 3.1 million kWh when compared with 2022.

In 2023, we set a primary corporate objective to keep our energy emissions below 2022 levels. We achieved a 11% reduction in location-based energy emissions when compared with 2022.

TSB began to buy 100% renewable electricity in October 2019 and is committed to continue to do so in the future.

Strategic report (continued)

TSB's Do What Matters Plan (continued)

Planet (continued)

Own operational emissions: Targets

The table below sets out the own operational emission targets that have been set and which are designed to drive action to deliver our net-zero by 2030 target.

Operational emissions area	Scope	Target	2023 Progress
Emissions from heating and cooling our estate	Scope 1	Maintain at or below 2022 level[(1)]	11% below 2022 (Achieved)
Indirect emissions from heating and cooling our estate	Scope 2	To buy 100% renewable electricity	(Achieved)
Waste	Scope 3	Reduce non-recyclable waste by 10% compared with 2022[(2)]	21% below 2022 (Achieved)
		To achieve a 90% recycling rate across all waste streams	76% (Not achieved)
Business Travel	Scope 3	To keep below 50% of 2019 levels	57% (Not achieved)
Water & Paper	Scope 3	To reduce paper consumption to 65% compared to 2019	66% below 2019 (Achieved)
Homeworking & Commuting	Scope 3	Target under development	n/a

(1) Target to keep location-based emissions from electricity, gas and oil below 2022 levels (4,451 tCO_2e).
(2) Target to reduce TSB general waste stream by 10% compared with 2022 levels (169.7 tonnes).

Science-based targets

We have paused validation of the science-based targets submitted to the Science Based Targets initiative in 2022 and await the publication of the Science Based Targets Initiative's Net-Zero Standard for Financial Institutions (expected early 2024). We will review the targets developed last year against the new Standard and will supply a further update in 2024.

Looking ahead to 2024

Our focus remains on using fewer resources and choosing more sustainable options to run our operations. This means continuing to reduce overall energy consumption through phase 3 of our energy optimisation scheme. This scheme is exploring the removal of fossil fuels from our estate, reducing waste in our operations, piloting new water saving technology, finding ways to remove paper from our processes, and eliminating any non Forest Stewardship Council UK (FSC) and non Programme for the Endorsement of Forest Certification (PEFC) paper products that remain in our operations. Further, it is promoting sustainable business travel options by only offering electric vehicles on our company car scheme and using a new travel booking provider to make emissions data more readily available to colleagues and provide prompts to choose sustainable travel methods where practical.

Financed emissions: Metrics

As part of the Net Zero Banking Alliance (NZBA), we are committed to reaching net-zero in our financed emissions by 2050. During 2023, we prioritised the emissions from our mortgage portfolio, in terms of both measuring and target setting as this portfolio accounted for 88% of TSB's total lending and investment portfolio and 84% of the financed emissions (using data from 2022 to baseline this assessment). To meet our commitments to the NZBA, we will review the remaining eight carbon intensive sectors in 2024 and set targets as needed.

The carbon emissions of our mortgage portfolio have been estimated using the Partnership for Carbon Accounting Financials (PCAF) methodology (which can be found at carbonaccountingfinancials.com) as set out in the table below.

Scope 3 financed residential mortgage emissions	At 31 Dec 2022*
Absolute carbon emissions (tonnes of CO_2)	510,109
Physical emissions intensity (kg of CO_2 per total property square metre)	20.14

* Due to the complexity in compiling this data, it is shown on a one-year lag. TSB commenced analysing scope 3 financed residential mortgage emissions during 2023 and therefore data for earlier periods has not been collated and no comparative is presented.

Strategic report (continued)

TSB's Do What Matters Plan (continued)

Planet (continued)

Financed emissions: Metrics (continued)

Assurance
TSB appointed Ernst and Young LLP (EY) to provide independent limited assurance over the above scope 3 financed residential mortgage emissions for the year ending 31 December 2022. The assurance engagement was planned and performed in accordance with the International Standard for Assurance Engagements (ISAE) 3000, Assurance Engagements Other than Audits for Reviews of Historical Financial information. A limited assurance report was issued and is available at https://www.tsb.co.uk/files/tsb-fy-2022-assurance-report.pdf. This report contains details of the scope, respective responsibilities, work performed, limitations and conclusions.

Methodology
Where available, CO_2 emissions and floor area for each property secured by a TSB mortgage have been obtained from the energy performance certificate (EPC). Emissions from expired EPCs that are more than ten years old and a small number of EPCs issued after 31 December 2022 have also been included as we believe this more accurately reflects individual property emissions than using modelled or average data. Where EPCs were unavailable, estimations have been made using either postcode averages or modelled data.

Under the PCAF methodology, the estimated CO_2 emissions attributable to TSB financing is calculated as the proportion of the mortgage loan balance compared to the indexed property value. At December 2022, this proportion was calculated using mortgage balances at December 2022 and indexed property values at December 2021 (or at December 2022 for properties without indexed valuation data at December 2021).

The PCAF methodology is also used to calculate a data quality score for our financed emission calculations. Under this methodology, a data quality score is calculated between 1 and 5, where 1 is the highest data quality and 5 is the lowest. This score is intended to highlight the use of estimations used in the calculations and allows TSB to check progress on improving data quality and coverage in the future. Our 2022 residential mortgage emissions data quality score was 3.33.

Further information on TSB's methodology and data can be found at https://www.tsb.co.uk/nzba-methodology.pdf.

Financed emissions: Targets
We have set an intermediate physical emissions intensity target for our residential mortgage emissions of 11.75 $kgCO_2/m^2$ by 31 December 2030, a reduction of 42% from our base year (2022).

As we set out in our NZBA report, our analysis shows that TSB action alone will not meet the target. Based on analysis and market conditions, TSB has found that it has an opportunity to achieve a reduction from its current emission level of 20.14 $kgCO_2/m^2$ to between 14.97 and 16.11 $kgCO_2/m^2$. This significantly advances TSB's position toward the 42% set target reduction under NZBA. However, to reach the required emissions level of 11.75 $kgCO_2/m^2$ will need significant engagement from government and others to create the environment for consumers to improve their properties.

We set out in our NZBA report the government led policy actions and the wider societal shifts, particularly by homeowners, we believe are necessary, highlighting where TSB can best influence those changes.

We are building awareness around retrofit measures by upskilling customer-facing colleagues and our mortgage intermediaries, enabling them to have conversations about home energy efficiency and low carbon heating options by signposting customers to Snugg, a tool to help them to see the value of completing retrofit improvements on their homes. We continue to enhance our partnership with Snugg and our customers can now access it through our Mortgage Hub in our mobile app, as well as through TSB Marketplace and Greener Homes webpages.

Strategic report (continued)

Section 172 statement

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

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

Each year the Board considers a refresh of the Bank's medium term plan which requires the Executive to consider the impact on various stakeholders and provides the Board with an opportunity to challenge the Executive in ensuring that appropriate consideration is given to the interests of all stakeholders. In 2023, the plan was comprehensively discussed across three Board meetings in October, November and December, with the interests of the Bank's respective stakeholders forming a key part of these deliberations. One particular area of focus of the discussions related to proposed restructuring activity designed to support delivery of TSB's strategy, with particular emphasis on the potential impacts on customers and colleagues and mitigating actions to be taken in this regard.

Customers

The Board takes account of customer experience through regular reviews of key measures such as Net Promoter Score and customer conduct metrics. A continuing focus for the Board in 2023, following the instigation of preparations in 2022, was the implementation of the FCA's Consumer Duty, including the impact on TSB and the programme of activity to enhance how TSB acts to deliver good outcomes for customers. These discussions took place across four Board meetings leading up to and following the regulatory implementation date in July 2023, which included consideration of internal and external assessments of readiness and Board challenge on progress against the previously approved implementation plan. The Board was also closely engaged throughout 2023 on the development by management of a number of journey dashboards to support TSB's monitoring of, and subsequent actions to deliver, good outcomes for customers. These Consumer Duty dashboards went live for management in August 2023, in line with the regulatory timetable, and will be reported on regularly to the Board to enable it to meet its obligations under the Duty. Alongside consideration of plans for Consumer Duty, and consistent with the approach taken in 2022, a spotlight discussion on vulnerable customers was also held, which continues to be an area of focus for the Board. As was the case in 2021 and 2022, the Board also held two 'deep dive' sessions on complaints in 2023 to provide ongoing support and challenge to management's efforts to improve the customer experience through root cause analysis of the main complaint types and to implement action plans to address the underlying causes identified.

In light of the continuing pressure on consumer finances resulting from various macroeconomic factors, there has been an ongoing focus by management on cost of living impacts on customer finances and behaviour. Visibility of this has been provided to the Board through the sharing of additional credit, savings and arrears data, introduced in 2022, which is also considered quarterly by the Risk Committee.

Colleagues

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

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

Strategic report (continued)

Section 172 statement (continued)

Colleagues (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. 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 2023, The Link focused on areas such as vulnerable customer and cost of living support, revisions to TSB's risk management framework, sustainability, and colleague related matters such as inclusion and social mobility, career development and training and mental health and wellbeing. The outputs from every meeting of The Link are presented to the Executive Committee to help inform TSB's decision making. The Board discussion with The Link focused on vulnerable customer support and colleague mental health and wellbeing, with the Board supportive of the recommendations put forward by The Link and offering suggestions for how these might best be achieved.

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

Suppliers
TSB believes that establishing a close relationship with suppliers (including a clear accountability framework) is a pre-requisite for resilient customer services. The Board approves the outsourcing strategy annually, together with any changes to the boundaries of outsourced critical services. Service excellence is a key part of TSB's strategy and, as part of this, TSB will continue to work closely with certain key suppliers. Page 16 sets out TSB's approach to the prompt payment of suppliers.

Communities
The Board also fully recognises its obligations to consider the interests of the wider communities in which TSB operates and this is demonstrated in its support of the Do What Matters Plan, TSB's responsible business plan, described in further detail starting on page 15. This outlines how, through delivery of TSB's purpose and strategy, TSB seeks to contribute to a better society. The Board receives regular updates on progress of the Do What Matters Plan through the Chief Executive's report, together with a more comprehensive annual update at which the ambition of, and progress against, management's plans are challenged.

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

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

Consideration of environmental and climate change matters
TSB's Do What Matters Plan formalises the Bank's commitment to reducing its impact on the environment while helping customers and employees do the same. As part of this plan, we have committed to reduce our environmental impact and deliver against our goals as outlined starting on page 19. In addition, the Board, through discussion of the topic at the Risk Committee, has engaged with the climate change agenda in 2023, inputting into management's plans to recognise and mitigate the risks to the business arising from climate change. Further commentary on climate change risk is included in the Risk management section on page 13.

Strategic report on pages 3 to 25 approved, by order of the Board.

K. Hl

Keith Hawkins
Company Secretary, 31 January 2024

Directors' report

Introduction

The Directors of TSB Bank plc (the 'Company') present their report and audited financial statements for the year ended 31 December 2023, in accordance with section 415 of the Companies Act 2006. The Colleagues and Suppliers sections of the Section 172 statement (pages 24 and 25), the People section of TSB's Do What Matters Plan section (pages 16 to 18), and the Own operational emissions: Metrics section on pages 20 and 21, are 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 25.

Dividends

The Directors paid an interim dividend of £120.0 million in 2023 (2022: £67.0 million). The Directors do not propose to pay a final dividend.

Directors

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

Directors' indemnities

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

With the exception of the Directors appointed during 2023, the indemnities were in place throughout 2023. The indemnities for Zahra Bahrololoumi and Ahmed Essam were executed on 21 March 2023. An indemnity for Judith Eden was executed on 2 January 2024. 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 (2018 edition) (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 Review of business performance on pages 3 to 4 and Company's business model on page 5.

Political donations and expenditure

No amounts were given for political purposes during the year (2022: £nil).

Financial instruments

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

Post balance sheet events

There are no significant events affecting the Company that have arisen between 31 December 2023 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.

Directors' report (continued)

Appointment of external auditor

The audit of the 2023 financial statements is the fourth 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 2023 financial statements, her fourth 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 2024 will be proposed at the 2024 Annual General Meeting.

Going concern

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

Viability assessment

The Directors' assessments of viability and principal and emerging risks can be found on page 48 of the annual report and accounts of the Company's parent, TSB Banking Group plc, under the heading 'viability statement.'

Statement of directors' responsibilities in respect of the financial statements

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

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

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

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

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

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

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

By order of the Board

Keith Hawkins
Company Secretary,
31 January 2024

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 25 to the financial statements on page 79. These consolidated financial statements have been prepared in accordance with UK adopted international accounting standards.

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

Going concern
The going concern basis is dependent on maintaining sufficient capital and funding. The Directors considered a number of factors including an assessment of principal risks and projections of capital, funding and liquidity. TSB's business activities and objectives, together with the factors likely to affect its future development, performance and position are set out in the Strategic report. In 2023, TSB reported a profit before tax for the year of £235.5 million (2022: £181.1 million) and continues to be in compliance with, and exceeds, its regulatory capital and liquidity requirements.

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

Accounting policies
The significant accounting policies used in the preparation of the consolidated financial statements are consistent with those applied in 2022. 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.

Adoption of new and revised IFRSs
The Group adopted the following International Accounting Standards Board (IASB) pronouncements in the current financial year, which have been endorsed for use in the UK by the UK Endorsement Board (UKEB), and are not considered to have a material impact for the Group:

- IFRS 17 'Insurance Contracts' establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard. IFRS 17 was effective for accounting periods beginning on or after 1 January 2023.

- International tax reform – Pillar Two model rules: Amendments to IAS 12. This was issued in May 2023 and is applicable for accounting periods beginning on or after 1 January 2023. The amendments introduce a mandatory temporary exception to the accounting for deferred taxes arising from the implementation of the OECD Pillar Two model rules, together with targeted disclosure requirements for affected entities. The Pillar Two model rules are not expected to have any financial impact for TSB, and therefore the application of the temporary exemption on adoption has resulted in neither the recognition nor disclosure of information about deferred tax assets and liabilities related to Pillar Two income taxes.

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

Index to the financial statements

The Bank's primary financial statements are presented on pages 30 to 33. The notes to these financial statements are structured to follow the Bank's business model as set out on page 5 and are listed below.

Balance sheets

as at 31 December 2023

	Note	Bank (Consolidated) 2023 £ million	Bank (Consolidated) 2022 £ million	Company 2023 £ million	Company 2022 £ million
Assets					
Financial assets at amortised cost:					
Cash, cash balances at central banks and other demand deposits		**5,897.3**	5,238.8	**5,897.3**	5,238.8
Debt securities	6	**2,124.2**	1,951.6	**2,124.2**	1,951.6
Loans and advances to customers	8	**36,245.9**	38,050.0	**36,245.9**	38,050.0
Loans and advances to central banks and credit institutions	7,32	**328.0**	303.5	**136.0**	144.3
Other advances	9	**209.6**	703.2	**209.6**	703.2
Financial assets at fair value through other comprehensive income					
Debt securities	6	**356.6**	509.5	**356.6**	509.5
Financial assets at fair value through profit or loss					
Derivative financial assets not in hedge accounting relationships	21	**822.9**	1,158.7	**806.7**	1,073.2
Hedging derivative financial assets	21	**1,346.9**	1,565.9	**1,346.9**	1,565.9
Fair value adjustments for portfolio hedged risk	21	**(154.9)**	(542.8)	**(154.9)**	(542.8)
Property and equipment	26	**253.5**	287.5	**253.5**	287.5
Intangible assets	28	**86.1**	75.6	**86.1**	75.6
Deferred tax assets	17	**43.2**	64.5	**43.2**	64.5
Other assets	29	**93.6**	83.6	**297.7**	322.8
Total assets		**47,652.9**	49,449.6	**47,648.8**	49,444.1
Liabilities					
Financial liabilities at amortised cost					
Customer deposits	1	**34,764.3**	36,338.2	**34,764.3**	36,338.2
Borrowings from central banks	2	**4,057.9**	5,538.3	**4,057.9**	5,538.3
Debt securities in issue	2	**3,664.1**	1,955.5	**3,664.1**	1,955.5
Repurchase agreements	2	**–**	360.0	**–**	360.0
Subordinated liabilities	3	**277.7**	265.4	**277.7**	265.4
Lease liabilities	27	**125.0**	145.9	**125.0**	145.9
Other financial liabilities	4	**1,222.4**	1,320.1	**1,222.4**	1,320.1
Financial liabilities at fair value through profit or loss					
Derivative financial liabilities not in hedge accounting relationships	21	**982.1**	1,252.4	**982.1**	1,252.4
Hedging derivative financial liabilities	21	**318.7**	301.5	**318.7**	301.5
Fair value adjustments for portfolio hedged risk	21	**(85.5)**	(321.3)	**(85.5)**	(321.3)
Provisions	30	**75.2**	125.0	**75.2**	125.0
Other liabilities	31	**296.4**	238.8	**296.0**	238.4
Total liabilities		**45,698.3**	47,519.8	**45,697.9**	47,519.4
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	22	**1,261.1**	1,207.7	**1,257.4**	1,202.6
Fair value reserve	22	**(6.5)**	(6.1)	**(6.5)**	(6.1)
Cash flow hedging reserve	22	**12.2**	40.4	**12.2**	40.4
Shareholder's equity		**1,954.6**	1,929.8	**1,950.9**	1,924.7
Total equity and liabilities		**47,652.9**	49,449.6	**47,648.8**	49,444.1

The accompanying notes are an integral part of the consolidated financial statements. No statement of comprehensive income has been shown for the Company, as permitted by section 408 of the Companies Act 2006. The consolidated and Company financial statements on pages 30 to 84 were approved by the Board of Directors on 31 January 2024 and signed on its behalf by:

Robin Bulloch
Chief Executive

Declan Hourican
Chief Financial Officer

Consolidated statement of comprehensive income

for the year ended 31 December 2023

Income statement (continuing operations):	Note	Bank 2023 £ million	Bank 2022 £ million
Interest and similar income:			
Interest income calculated using the effective interest method	11	**1,573.5**	1,123.0
Other interest income	11	**368.6**	108.7
Total interest and similar income		**1,942.1**	1,231.7
Interest and similar expense	11	**(920.1)**	(250.0)
Net interest income	11	**1,022.0**	981.7
Fee and commission income	12	**129.2**	135.5
Fee and commission expense	12	**(21.2)**	(21.3)
Net fee and commission income	12	**108.0**	114.2
Net gains/(losses) on financial assets and liabilities:			
Gains on derecognition of financial assets measured at fair value through other comprehensive income		**4.3**	6.3
Losses on derecognition of financial liabilities measured at amortised cost		**(1.0)**	–
Gains/(losses) on derivative financial instruments at fair value through profit or loss		**11.2**	(8.1)
(Losses)/gains from hedge accounting	21	**(2.2)**	4.2
(Losses)/gains on derecognition of non-financial assets and liabilities		**(0.1)**	0.6
Other operating income	13	**14.5**	6.6
Other income		**134.7**	123.8
Total income		**1,156.7**	1,105.5
Total operating expenses	14	**(852.9)**	(869.5)
Operating profit before impairment losses and taxation		**303.8**	236.0
Impairment losses on financial assets at amortised cost	18	**(71.8)**	(57.7)
Impairment credit on loan commitments	30	**3.5**	2.8
Total impairment losses		**(68.3)**	(54.9)
Profit before taxation		**235.5**	181.1
Taxation	16	**(62.1)**	(80.5)
Profit for the year	22	**173.4**	100.6
Other comprehensive income:			
Items that may be subsequently reclassified to profit or loss:			
Change in fair value reserve:			
Change in fair value	21	**3.7**	(17.3)
Transfers to the income statement	21	**(4.4)**	(6.3)
Taxation thereon	17	**0.3**	6.4
	22	**(0.4)**	(17.2)
Change in cash flow hedging reserve:			
Change in the fair value of derivatives in cash flow hedges	21	**(34.7)**	63.5
Transfers to the income statement	21	**(4.4)**	1.7
Taxation thereon	17	**10.9**	(18.2)
	22	**(28.2)**	47.0
Other comprehensive (losses)/income for the year, net of taxation		**(28.6)**	29.8
Total comprehensive income for the year		**144.8**	130.4

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

Statements of changes in equity

for the year ended 31 December 2023

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 2022	79.4	195.6	412.8	11.1	(6.6)	1,174.1	1,866.4
Comprehensive profit:							
Profit for the year	–	–	–	–	–	100.6	100.6
Other comprehensive (losses)/income	–	–	–	(17.2)	47.0	–	29.8
Total comprehensive (losses)/income	–	–	–	(17.2)	47.0	100.6	130.4
Transactions with owner:							
Dividend paid	–	–	–	–	–	(67.0)	(67.0)
Total transactions with owner	–	–	–	–	–	(67.0)	(67.0)
Balance at 31 December 2022	79.4	195.6	412.8	(6.1)	40.4	1,207.7	1,929.8
Comprehensive profit:							
Profit for the year	**–**	**–**	**–**	**–**	**–**	**173.4**	**173.4**
Other comprehensive losses	**–**	**–**	**–**	**(0.4)**	**(28.2)**	**–**	**(28.6)**
Total comprehensive (losses)/income	**–**	**–**	**–**	**(0.4)**	**(28.2)**	**173.4**	**144.8**
Transactions with owner:							
Dividend paid	**–**	**–**	**–**	**–**	**–**	**(120.0)**	**(120.0)**
Total transactions with owner	**–**	**–**	**–**	**–**	**–**	**(120.0)**	**(120.0)**
Balance at 31 December 2023	**79.4**	**195.6**	**412.8**	**(6.5)**	**12.2**	**1,261.1**	**1,954.6**

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 2022	79.4	195.6	412.8	11.1	(6.6)	1,174.1	1,866.4
Comprehensive income:							
Profit for the year	–	–	–	–	–	95.5	95.5
Other comprehensive (losses)/income	–	–	–	(17.2)	47.0	–	29.8
Total comprehensive (losses)/income	–	–	–	(17.2)	47.0	95.5	125.3
Transactions with owner:							
Dividend paid	–	–	–	–	–	(67.0)	(67.0)
Total transactions with owner	–	–	–	–	–	(67.0)	(67.0)
Balance at 31 December 2022	79.4	195.6	412.8	(6.1)	40.4	1,202.6	1,924.7
Comprehensive income:							
Profit for the year	**–**	**–**	**–**	**–**	**–**	**174.8**	**174.8**
Other comprehensive losses	**–**	**–**	**–**	**(0.4)**	**(28.2)**	**–**	**(28.6)**
Total comprehensive (losses)/income	**–**	**–**	**–**	**(0.4)**	**(28.2)**	**174.8**	**146.2**
Transactions with owner:							
Dividend paid	**–**	**–**	**–**	**–**	**–**	**(120.0)**	**(120.0)**
Total transactions with owner	**–**	**–**	**–**	**–**	**–**	**(120.0)**	**(120.0)**
Balance at 31 December 2023	**79.4**	**195.6**	**412.8**	**(6.5)**	**12.2**	**1,257.4**	**1,950.9**

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

Cash flow statements

for the year ended 31 December 2023

	Note	Bank (Consolidated) 2023 £ million	Bank (consolidated) 2022[1] Restated £ million	Company 2023 £ million	Company 2022 £ million
Cash flows from operating activities					
Profit before taxation		**235.5**	181.1	**236.9**	176.0
Adjustments for:					
Change in operating assets and liabilities[(1)(2)]	32	**333.6**	202.3	**368.7**	18.8
Non-cash and other items	32	**664.6**	247.4	**595.3**	332.9
Taxation paid		**(33.0)**	(34.4)	**(33.0)**	(34.4)
Net cash provided by operating activities[(1)]		**1,200.7**	596.4	**1,167.9**	493.3
Cash flows from investing activities					
Purchase of property and equipment		**(20.2)**	(36.8)	**(20.2)**	(36.8)
Purchase and development of intangible assets		**(28.0)**	(17.5)	**(28.0)**	(17.5)
Purchase of debt securities		**(219.8)**	(580.1)	**(219.8)**	(580.1)
Sale of debt securities		**252.6**	442.6	**252.6**	442.6
Proceeds from maturing investments		**39.3**	67.0	**39.3**	67.0
Interest received on debt securities		**64.6**	44.5	**64.6**	44.5
Net cash received/(used) in investing activities		**88.5**	(80.3)	**88.5**	(80.3)
Cash flows from financing activities					
Additional borrowings from central banks		**5.0**	510.0	**5.0**	510.0
Repayment of borrowing from central banks		**(1,500.0)**	(510.0)	**(1,500.0)**	(510.0)
Interest paid on borrowings from central banks		**(191.7)**	(57.3)	**(191.7)**	(57.3)
Issue of covered bonds		**1,750.0**	–	**1,750.0**	–
Buyback of covered bonds		**(251.0)**	(500.0)	**(251.0)**	(500.0)
Interest paid on covered bonds		**(120.1)**	(29.5)	**(120.1)**	(29.5)
Issue of senior unsecured debt securities		**200.0**	700.0	**200.0**	700.0
Repayment of senior unsecured debt securities		**–**	(450.0)	**–**	(450.0)
Interest paid on senior unsecured debt securities		**(51.1)**	(15.8)	**(51.1)**	(15.8)
Interest paid on subordinated liabilities		**(10.3)**	(10.3)	**(10.3)**	(10.3)
(Repayment)/issue of repurchase agreements		**(359.9)**	359.9	**(359.9)**	359.9
Interest paid on repurchase agreements		**(1.0)**	(2.6)	**(0.9)**	(2.6)
Lease payments		**(17.8)**	(19.7)	**(17.9)**	(19.7)
Dividends paid		**(50.0)**	–	**(50.0)**	–
Net cash provided by financing activities		**(597.9)**	(25.3)	**(597.9)**	(25.3)
Change in cash and cash equivalents[(1)]		**691.3**	490.8	**658.5**	387.7
Cash and cash equivalents at 1 January[(1)]	32	**5,398.0**	4,907.2	**5,238.8**	4,851.1
Cash and cash equivalents at 31 December	32	**6,089.3**	5,398.0	**5,897.3**	5,238.8

(1) Comparative amounts have been restated to include on demand loans and advances to credit institutions as cash and cash equivalents. This had the effect of increasing each of Change in operating assets and liabilities, Net cash provided by operating activities, and Change in cash and cash equivalents by £103.1 million. Cash and cash equivalents at 1 January 2023 was increased by £159.2 million and Cash and cash equivalents at 1 January 2022 was increased by £56.1 million. See note 32 for further information.

(2) In the prior year, net change in derivative financial instruments and fair value adjustments for portfolio hedged risk of £63.1 million was reclassified from Change in operating assets and liabilities to Non-cash and other items to align with the current year presentation. See note 32 for further information.

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

Notes to the financial statements

Sources of funding

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

Accounting policies relevant to sources of funding

(a) Financial liabilities

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

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

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

1. Customer deposits

Bank and Company	2023 £ million	2022 £ million
Bank accounts	**12,406.2**	14,070.6
Instant access saving deposits	**14,919.3**	16,387.8
Deposits with agreed maturity	**4,963.6**	3,153.7
Business banking deposits	**2,475.2**	2,726.1
Total customer deposits	**34,764.3**	36,338.2

2. Wholesale funding

(i) Debt securities in issue

Bank and Company 2023	Balance at 1 Jan 2023 £ million	Issues/ (Repayments) £ million	Accounting adjustments[1] £ million	Balance at 31 Dec 2023 £ million
Covered bond programme:				
Series 2019-1 covered bonds	**753.6**	**(250.0)**	**0.3**	**503.9**
Series 2021-1 covered bonds	**499.5**	**–**	**0.5**	**500.0**
Series 2023-1 covered bonds	**–**	**1,000.0**	**5.9**	**1,005.9**
Series 2023-2 covered bonds	**–**	**750.0**	**0.1**	**750.1**
	1,253.1	**1,500.0**	**6.8**	**2,759.9**
Senior unsecured debt securities	**702.4**	**200.0**	**1.8**	**904.2**
Total debt securities in issue	**1,955.5**	**1,700.0**	**8.6**	**3,664.1**

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

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

Notes to the financial statements

Sources of funding (continued)

2. Wholesale funding (continued)

Bank and Company	Date of issue	31 Dec 2023 £ million	31 Dec 2022 £ million	Interest rate at 31 Dec 2023	Maturity date	Issue currency
Issuing entity						
TSB Bank plc – Series 2019-1 covered bonds	02/2019	**503.9**	753.6	6.07%	02/2024	GBP
TSB Bank plc – Series 2021-1 covered bonds	06/2021	**500.0**	499.5	5.56%	06/2028	GBP
TSB Bank plc – Series 2023-1 covered bonds	02/2023	**1,005.9**	–	5.80%	02/2027	GBP
TSB Bank plc – Series 2023-2 covered bonds	09/2023	**750.1**	–	5.84%	09/2028	GBP
TSB Bank plc – senior unsecured debt securities	06/2022	**451.8**	451.3	7.64%	06/2027	GBP
TSB Bank plc – senior unsecured debt securities	12/2022	**251.2**	251.1	8.59%	12/2026	GBP
TSB Bank plc – senior unsecured debt securities	12/2023	**201.2**	–	8.48%	12/2028	GBP
Total debt securities in issue		**3,664.1**	1,955.5			

Covered bond programmes

Loans and advances to customers of £4,945.3 million (2022: £3,319.3 million) have been assigned to a limited liability partnership to provide security for the issuance of covered bonds, which at 31 December 2023 totalled £2,759.9 million (2022: £1,253.1 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.

Deposits of £138.6 million (2022: £77.8 million) held by TSB are available for the repayment of the term advances related to covered bonds and other legal obligations. At 31 December 2023, 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 2023 or 2022. During 2023 and 2022, there were no defaults on any principal or interest or any other breaches with respect to borrowings under the covered bond programmes.

During 2023, three tranches of covered bonds were issued, comprising £1,000.0 million in February 2023, £750.0 million in September 2023, and £500.0 million in November 2023. The November 2023 issuance was fully retained and has been used as collateral for a repurchase agreement transaction (see note 21 on page 74, under the heading Offsetting financial assets and financial liabilities).

In September 2023, covered bonds with a notional amount of £250.0 million were repurchased at a premium which, together with transaction costs, resulted in the recognition of a loss on extinguishment of £1.0 million. This was recognised in Losses on financial instruments carried at amortised cost in the income statement.

Senior unsecured debt securities in issue

In December 2023, the Company issued £200.0 million floating rate notes, due to mature in December 2028, to its parent company, Sabadell, to satisfy MREL requirements. These were issued at a price of 100% of the principal amount. The notes pay interest at SONIA plus 3.28% payable quarterly in arrears. The Company has the option to redeem these notes in December 2025 and quarterly thereafter, subject to approval of the PRA.

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

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

Securitisation programmes

At 31 December 2023, loans and advances to customers include £1,299.4 million (2022: £1,274.2 million) of mortgages securitised under a securitisation programme, which have been sold to bankruptcy remote structured entities. As these entities are funded by the issue of debt on terms whereby the majority of the risks and rewards of the mortgages are retained by TSB, the structured entities are consolidated fully and all of these loans are retained on TSB's balance sheet. At 31 December 2023, all related notes in issue were retained by TSB and therefore no amounts were recognised in debt securities in issue. Deposits of £53.4 million (2022: £81.4 million) held by TSB structured entities are available for the repayment of the debt securities issued by the structured entity and other legal obligations.

Notes to the financial statements

Sources of funding (continued)

2. Wholesale funding (continued)

(ii) Borrowings from central banks

At 31 December 2023, borrowings from central banks represented borrowings under the Bank of England's Term Funding Scheme with additional incentives for SMEs (TFSME). Such borrowings are secured on certain pre-positioned mortgages at the BOE. The TFSME borrowings outstanding at 31 December 2023 are due to mature at various dates, with £3,412.0 million due to mature during 2025 and the remaining £588.0 million during 2027. The Indexed Long Term Repo operations borrowings outstanding at 31 December 2023 mature during the first half of 2024.

Bank and Company	2023 £ million	2022 £ million
Term Funding Scheme with additional incentives for SMEs	**4,000.0**	5,000.0
Indexed Long Term Repo operations	**5.0**	500.0
Accrued interest	**52.9**	38.3
Total borrowings from central banks	**4,057.9**	5,538.3

(iii) Repurchase agreements

At 31 December 2023, TSB had entered into £nil (2022: £360.0 million) of repurchase agreements that transferred legal title of certain UK gilts in return for cash, together with an agreement to repurchase the assets at a later date and at a predetermined price.

The fair value of the transferred gilts was £nil (2022: £360.3 million), comprising £nil (2022: £165.4 million) of gilts recognised on TSB's balance sheet and £nil (2022: £194.9 million) received under reverse repurchase agreements. The on balance sheet gilts were not derecognised from the balance sheet, as substantially all of the rewards, including interest income, and risks, including credit and interest rate risks, are retained by TSB. In all cases, the transferee has the right to sell or repledge the gilts concerned, subject to delivering the securities at the repurchase date.

3. Subordinated liabilities

Bank and Company	2023 £ million	2022 £ million
Fixed-to-floating rate callable subordinated Tier 2 capital notes, due March 2031	**300.0**	300.0
Accrued interest	**0.1**	0.1
Fair value hedge accounting adjustment (note 21)	**(22.4)**	(34.7)
Total subordinated liabilities	**277.7**	265.4

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

4. Other financial liabilities

Bank and Company	2023 £ million	2022 £ million
Items in the course of transmission to credit institutions	**118.2**	59.0
Items in the course of transmission to non-credit institutions	**178.1**	4.7
Collateral placed by central clearing houses	**924.8**	1,245.5
Collateral placed by credit institutions	**0.8**	10.1
Deposits from credit institutions	**0.5**	0.8
Total other financial liabilities	**1,222.4**	1,320.1

Collateral placed by central clearing houses and by credit institutions represents cash collateral in respect of interest rate derivatives.

Notes to the financial statements

Sources of funding (continued)

5. Fair value of financial liabilities

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

Bank and Company	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2023					
Customer deposits	**–**	**34,787.9**	**–**	**34,787.9**	**34,764.3**
Debt securities in issue	**2,761.2**	**914.4**	**–**	**3,675.6**	**3,664.1**
Subordinated liabilities	**–**	**271.1**	**–**	**271.1**	**277.7**
Derivative liabilities at fair value through profit or loss	**–**	**982.1**	**–**	**982.1**	**982.1**
Hedging derivative liabilities	**–**	**318.7**	**–**	**318.7**	**318.7**
At 31 December 2022					
Customer deposits	–	36,322.9	–	36,322.9	36,338.2
Debt securities in issue	1,249.7	722.6	–	1,972.3	1,955.5
Subordinated liabilities	–	276.2	–	276.2	265.4
Derivative liabilities at fair value through profit or loss	–	1,252.4	–	1,252.4	1,252.4
Hedging derivative liabilities	–	301.5	–	301.5	301.5

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

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

The carrying amount of borrowings from central banks, repurchase agreements, and other financial liabilities is a reasonable approximation of fair value as these balances are either on demand or variable rate. 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 2023 or 2022.

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

Notes to the financial statements

Loans and liquid assets

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

Accounting policies relevant to loans and liquid assets

(b) Classification and measurement of financial assets

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

Classification and measurement

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

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

Financial assets that are debt instruments measured at amortised cost

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

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

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

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

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

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

Notes to the financial statements

Loans and liquid assets (continued)

Accounting policies relevant to loans and liquid assets (continued)

(c) Impairment of financial assets

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

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

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

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

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

Significant increase in credit risk

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

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

Credit Impaired (stage 3)

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

Definition of default for IFRS 9

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

Loans and liquid assets (continued)

Accounting policies relevant to loans and liquid assets (continued)

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

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

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

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

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

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

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

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

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

Notes to the financial statements

Loans and liquid assets (continued)

6. Debt securities

Bank and Company

Fair value through other comprehensive income (FVOCI)	**2023 £ million**	**2022 £ million**
UK Gilts	**356.6**	509.5
Total debt securities at FVOCI	**356.6**	509.5

Amortised cost	**2023 £ million**	**2022 £ million**
UK Gilts	**1,415.2**	1,352.2
Supranational and development bank bonds	**296.2**	289.3
Covered bonds	**412.8**	310.1
Total debt securities at amortised cost	**2,124.2**	1,951.6

Debt securities of £356.6 million (2022: £509.5 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 £2,124.2 million (2022: £1,951.6 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 2023, UK gilts at FVOCI with a carrying value of £nil (2022: £165.4 million) were subject to a repurchase agreement. This repurchase agreement was offset with a corresponding reverse repurchase agreement with the same counterparty when presented on the consolidated balance sheet (see note 21 on page 74 under the heading of Offsetting financial assets and financial liabilities. In addition, £420.6 million (2022: £48.2 million) of debt securities at amortised cost had been pledged as collateral.

7. Loans and advances to central banks and credit institutions

Bank	**2023 £ million**	**2022 £ million**
Loans and advances to central banks	**136.0**	144.3
Loans and advances to credit institutions	**192.0**	159.2
Total	**328.0**	303.5

Company	**2023 £ million**	**2022 £ million**
Loans and advances to central banks	**136.0**	144.3
Total	**136.0**	144.3

Loans and advances to central banks represent mandatory deposits at the Bank of England.

Notes to the financial statements

Loans and liquid assets (continued)

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

	2023 £ million	2022 £ million
Retail – mortgages	**34,047.5**	35,655.0
Retail – unsecured	**1,880.7**	1,958.4
Business banking	**475.6**	571.9
	36,403.8	38,185.3
Allowance for credit impairment losses (note 18)	**(211.8)**	(198.0)
Net customer lending balances	**36,192.0**	37,987.3
Valuation adjustments(1)	**53.9**	62.7
Loans and advances to customers	**36,245.9**	38,050.0

(1) Comprises accrued interest of £20.3 million (2022: £18.8 million) and effective interest rate adjustments of £33.6 million (2022: £43.9 million).

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

	2023 £ million	2022 £ million
Retail – mortgages	**1,898.4**	1,712.0
Retail – unsecured	**3,847.6**	3,859.4
Business banking	**66.6**	46.0
Total commitments	**5,812.6**	5,617.4

The credit impairment provision in respect of total loan commitments is shown in note 30 on page 81.

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

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

Forward looking economic scenarios
TSB currently uses four economic scenarios (2022: four scenarios), representative of management's view of forecast economic conditions. Key scenario assumptions are set internally for GDP, house prices, unemployment, inflation and interest rates. The forecasts for these metrics is compared with external sources to ensure they are suitably benchmarked.

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

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

The four scenarios, together with the weightings applied at December 2023, are described below.

Notes to the financial statements

Loans and liquid assets (continued)

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

Forward looking economic scenarios (continued)

2023 economic scenarios

Base case scenario (60% weighting)
The base case assumes that the UK narrowly avoids a recession. However, a sustained period of below-trend growth leads to higher unemployment (peaking at 4.75%) and a fall in house prices (down 13% from peak to trough). Bank Rate is assumed to have peaked at 5.25%. Inflation gradually returns to the 2% target.

The base case scenario is somewhat less pessimistic than the base scenario used in 2022. This is largely a reflection of the economy's observed resilience in 2023. The assumption of a slightly larger fall in house prices reflects the higher peak for the policy rate (5.25% rather than 4.5%).

Upside (10% weighting)
The upside scenario assumes that inflation pressures fade more quickly than in the base case. This leads to higher growth in real wages, which supports consumer spending and GDP. It also paves the way for earlier rate cuts. Unemployment starts to fall in 2024, returning to 3.5% by the end of the year. House prices are more resilient and recover more quickly.

Downside scenario (20% weighting)
Initially, the downside scenario emphasises the risks from greater inflationary persistence. This prompts the Bank of England to raise the policy rate further in 2024, to a peak of 6.5%. Additional monetary tightening would, on its own, lead to a weaker economic outlook. However, this effect is amplified by the assumption that it triggers a bout of financial instability. The economy falls into recession and there is a sharp rise in unemployment. House prices decline by 18%. The Bank of England eventually loosens monetary policy, ultimately cutting the policy rate further than in the base case.

Severe downside (high interest rate) scenario (10% weighting)
As in 2022, the severe downside scenario assumes that high and persistent inflation prompts an aggressive policy response by the Bank of England. Bank Rate rises to 7.5%, which leads to a deep recession, with GDP falling by 5.0% over the course of 2024. Unemployment rises to 8.5% and house prices fall by >30%.

2022 economic scenarios

Base case scenario (60% weighting)
The base case assumed that the UK was already in recession, which continued in 2023. This downturn led to higher unemployment (peaking at 5.25%) and a fall in house prices (down 10% from peak to trough). The Bank of England base rate (Bank Rate) was forecast to peak at 4.5%.

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

Upside (10% weighting)
The upside scenario assumed that the current recession would be brief, with stagnation rather than contraction in 2023. Inflation was expected to fade more quickly while Bank Rate peaked at 3.5%. Unemployment was forecast to remain broadly flat at 3.75% and house prices to recover more quickly.

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

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

Notes to the financial statements

Loans and liquid assets (continued)

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

Scenario weightings

	Base case	Upside	Downside	Severe downside
2023	**60%**	**10%**	**20%**	**10%**
2022	60%	10%	20%	10%

Scenario weightings have not changed from those applied in 2022. TSB retains a clear downside skew with the probability attached to the upside scenario (10%) being significantly lower than the combined weight of the downside scenarios (30%). This reflects concerns about inflationary persistence and the effects of rate hikes on economic growth and financial stability.

Annual average value of key inputs to the scenarios

At 31 December 2023 Scenario	Weighting	Input[1]	2024	2025	2026	2027	2028
Upside	**10%**	GDP	**1.2 %**	**2.7 %**	**1.7 %**	**1.6%**	**1.6%**
		Unemployment	**3.8 %**	**3.5 %**	**3.5 %**	**3.5%**	**3.5%**
		House prices	**(0.9)%**	**0.7 %**	**1.1 %**	**2.2%**	**3.7%**
		Interest rates	**4.25 %**	**4.25 %**	**4.25 %**	**4.25%**	**4.25%**
Base	**60%**	GDP	**0.3 %**	**0.9 %**	**1.3 %**	**1.4%**	**1.4%**
		Unemployment	**4.75 %**	**4.75 %**	**4.5 %**	**4.5%**	**4.5%**
		House prices	**(7.5)%**	**0.6 %**	**2.4 %**	**2.5%**	**2.5%**
		Interest rates	**5.0 %**	**4.25 %**	**4.0 %**	**4.0%**	**4.0%**
Downside	**20%**	GDP	**(1.0)%**	**(1.1)%**	**1.2 %**	**1.4%**	**1.2%**
		Unemployment	**6.1 %**	**6.5 %**	**6.0 %**	**5.4%**	**4.8%**
		House prices	**(10.8)%**	**(5.4)%**	**0.0 %**	**0.0%**	**2.8%**
		Interest rates	**6.25 %**	**3.5 %**	**3.5 %**	**3.5%**	**3.5%**
Severe downside (High rate)	**10%**	GDP	**(2.7)%**	**(1.6)%**	**1.2 %**	**1.2%**	**1.2%**
		Unemployment	**7.6 %**	**8.3 %**	**7.7 %**	**7.1%**	**6.5%**
		House prices	**(10.8)%**	**(15.2)%**	**(8.3)%**	**7.2%**	**6.6%**
		Interest rates	**7.5 %**	**7.0 %**	**6.0 %**	**5.0%**	**4.5%**
Weighted average	**n/a**	GDP	**(0.2)%**	**0.4 %**	**1.3 %**	**1.4%**	**1.4%**
		Unemployment	**5.2 %**	**5.3 %**	**5.0 %**	**4.8%**	**4.7%**
		House prices	**(7.9)%**	**(2.1)%**	**0.9 %**	**2.4%**	**3.0%**
		Interest rates	**5.4 %**	**4.4 %**	**4.1 %**	**4.0%**	**4.0%**

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

Notes to the financial statements

Loans and liquid assets (continued)

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

Annual average value of key inputs to the scenarios (continued)
In the table above, GDP is the annual change in forecast GDP for each year. Unemployment is presented as the Q4 forecast for each year. House price changes are presented as the year-on-year change in Q4 forecast house prices in each year. Interest rates are Bank Rate in December each year.

Key variables in each of the scenarios are assumed to revert to a long term constant rate over a period of up to two years after the end of the forecast period. The reversionary rates used are as follows: GDP 1.5% (2022: 1.5%), unemployment 4.5% (2022: 4.0%); interest rates 3.5% (2022: 1.5%); and house price growth of 3.75% (2022: 3.75%) per annum.

Cumulative expected growth and fall of key inputs to the forecast scenarios
The table below shows the cumulative forecast growth and fall of key inputs from the reporting date to the forecast peak and forecast trough during the forecast period.

At 31 December 2023[1]		Base case	Upside	Downside	Severe downside (High rate)
GDP	Peak to trough fall	**n/a**	**n/a**	**(2.2)%**	**(5.0)%**
Unemployment	Peak rate	**4.8 %**	**n/a**	**6.6 %**	**8.5 %**
House prices	Peak-to-trough fall	**(7.0)%**	**n/a**	**(15.0)%**	**(32.0)%**
Interest rates	Most extreme rate	**5.25 %**	**4.25%**	**6.5 %**	**7.5 %**
At 31 December 2022					
GDP	Peak to trough fall	(1.3)%	n/a	(3.7)%	(5.0)%
Unemployment	Peak rate	5.25 %	3.75%	6.4 %	8.5 %
House prices	Peak-to-trough fall	(10.0)%	(5.0)%	(18.0)%	(32.0)%
Interest rates	Most extreme rate	4.5 %	3.5 %	4.25 %	7.0 %

(1) GDP decline is relative to Q4 2023. Unemployment peak is from Q1 2024 onwards. House price decline is relative to December 2023. The most extreme interest rate is the interest rate furthest from the current rate, either positive or negative during the forecast period.

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

At 31 December 2023	Weighted £ million	Upside £ million	Base case £ million	Downside £ million	Severe downside £ million
Gross customer lending balances:					
Stage 1	**32,115.9**	**32,773.5**	**32,381.8**	**31,873.7**	**29,055.7**
Stage 2	**3,684.9**	**3,027.3**	**3,419.0**	**3,927.1**	**6,745.1**
Stage 3	**508.1**	**508.1**	**508.1**	**508.1**	**508.1**
POCI	**94.9**	**94.9**	**94.9**	**94.9**	**94.9**
Total gross customer lending balances	**36,403.8**	**36,403.8**	**36,403.8**	**36,403.8**	**36,403.8**
Allowance for credit losses and credit impairment provisions:					
Stage 1	**60.5**	**55.9**	**57.2**	**61.6**	**64.7**
Stage 2	**80.9**	**54.5**	**69.1**	**97.5**	**179.7**
Stage 3	**79.8**	**73.4**	**77.2**	**84.0**	**89.0**
POCI	**1.0**	**0.7**	**0.9**	**1.2**	**1.6**
Total allowance for credit losses and credit impairment provisions[1]	**222.2**	**184.5**	**204.4**	**244.3**	**335.0**

(1) Weighted amount comprises of allowance for credit losses of £211.8 million and credit impairment provisions of £10.4 million (note 30).

Notes to the financial statements

Loans and liquid assets (continued)

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

Sensitivity to alternative economic scenario weightings (continued)

At 31 December 2022	Weighted £ million	Upside £ million	Base case £ million	Downside £ million	Severe downside £ million
Gross customer lending balances:					
Stage 1	33,737.1	34,921.0	33,950.9	33,674.6	28,950.0
Stage 2	3,866.8	2,682.9	3,653.0	3,929.3	8,653.9
Stage 3	472.1	472.1	472.1	472.1	472.1
POCI	109.3	109.3	109.3	109.3	109.3
Total gross customer lending balances	38,185.3	38,185.3	38,185.3	38,185.3	38,185.3
Allowance for credit losses and credit impairment provisions:					
Stage 1	42.5	37.6	37.8	44.1	44.4
Stage 2	103.2	58.5	80.6	112.5	270.7
Stage 3	65.5	61.1	63.5	65.9	69.8
POCI	0.7	0.5	0.7	0.7	1.0
Total allowance for credit losses and credit impairment provisions(1)	211.9	157.7	182.6	223.2	385.9

(1) Weighted amount comprises of allowance for credit losses of £198.0 million and credit impairment provisions of £13.9 million (note 30).

Included in the weighted ECL of £222.2 million (2022: £211.9 million) are post model adjustments of £52.6 million (2022: £49.3 million) which are included in the above macroeconomic sensitivity.

In undertaking the sensitivity of the ECL to alternative scenarios, balances in stage 3 at the balance sheet date remain constant in each scenario. Any change in stage 3 balances in each scenario is assumed to take place subsequent to the balance sheet date as cases move in to and out of arrears. The differences across the scenarios for stage 1 and stage 2 balances reflect the change to the modelled PD in each scenario, which is a key determinant in assessing when there has been a significant increase in credit risk.

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 (PMAs)
The allowance for credit impairment losses included PMAs as shown below:

	Retail - Mortgages £ million	Retail - Unsecured £ million	Business banking £ million	2023 £ million	Retail - Mortgages £ million	Retail - unsecured £ million	Business banking £ million	2022 £ million
ECL before judgemental adjustments	**6.9**	**144.5**	**7.8**	**159.2**	4.5	139.3	4.9	148.7
Judgemental adjustments:								
Post model adjustments:								
Impairment default triggers	**22.5**	**5.9**	**0.8**	**29.2**	30.4	16.2	3.5	50.1
Model performance	**27.0**	**(5.0)**	**(1.6)**	**20.4**	18.3	(22.7)	(2.4)	(6.8)
Operational matters	**1.0**	**2.3**	**(1.1)**	**2.2**	0.9	2.6	1.2	4.7
Bounce Back Loan Scheme	**–**	**–**	**0.8**	**0.8**	–	–	1.3	1.3
Total judgemental adjustments	**50.5**	**3.2**	**(1.1)**	**52.6**	49.6	(3.9)	3.6	49.3
Allowance for credit impairment losses	**57.4**	**147.7**	**6.7**	**211.8**	54.1	135.4	8.5	198.0

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

Impairment default triggers

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

Notes to the financial statements

Loans and liquid assets (continued)

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

Impairment default triggers (continued)

- During 2023, the value of PMAs required to recognise drivers of default not fully captured in the existing ECL models, reduced by £20.9 million to £29.2 million (2022: £50.1 million) reflecting an easing of inflationary pressures. The impact on customers' ability to afford their mortgage payments in the light of heightened inflation is captured through an affordability assessment that uses external credit bureau data and customer data. Customers with negative affordability are considered to have experienced a significant increase in credit risk and subsequently leads to an increase in credit losses. The PMAs for the unsecured portfolio are determined by an affordability assessment using internal current account data, supplemented with external data where appropriate.

Model performance

- PMAs are required to mitigate risks associated with model performance. An example of this is the requirement to capture the impact of economic projections falling outside of the range of historical observations on which models were developed or where models are underpredicting recent performance ahead of model recalibration being undertaken. During 2023, this category of PMAs increased by £27.2 million to £20.4 million (2022: £(6.8) million) reflecting the effect of the revised outlook for house prices on the Retail – mortgages portfolio, and oversensitivity of the PD models to forecast unsecured customer debt to income levels.

Operational matters

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

Bounce Back Loan Scheme

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

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 39. 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 2023, loans and advances to customers were considered to have experienced a significant increase in credit risk (and classified in stage 2) if the residual lifetime PD had increased by both the relative threshold (being a multiplier of the origination PD) and the absolute increase in PD, both as compared to the PD at time of the loan's origination, as follows:

	2023 Relative Increase in PD	2023 Absolute Increase in PD	2022 Relative Increase in PD	2022 Absolute Increase in PD
Retail - mortgages				
Core mortgages	**2 times**	**410bps**	2 times	410bps
Whistletree	**2 times**	**10bps**	2 times	10bps
Retail - unsecured				
Credit cards	**2 times**	**250bps**	2 times	250bps
Personal loans	**2 times**	**770bps**	2 times	770bps
Overdrafts	**1 times**	**400bps**	1 times	400bps
Business banking	**2 times**	**50bps**	2 times	50bps

In assessing the appropriateness of this judgement, management applied a framework that considered a number of quantitative factors, including the accuracy of the thresholds and their predictive ability. As a result of this assessment, it was determined that thresholds have performed appropriately during the year, with no changes required.

Further to this, PMAs were applied to the modelled staging outcomes to align with the PMAs applied in measuring the impairment allowance. This resulted in the net transfer of £1,690.0 million (2022: £650.0 million) gross Retail - mortgages balances from stage 1 to stage 2, largely to capture the effects of the affordability PMA (recorded under impairment default triggers) and £231.0 million (2022: £nil) Whistletree balances from stage 1 to stage 2 to capture pending PD model recalibrations. Partially offsetting this, was a transfer of £43.0 million (2022: £42.5 million) from stage 2 to stage 1 in Business banking to address known model performance matters.

Notes to the financial statements

Loans and liquid assets (continued)

9. Other advances

Bank and Company	2023 £ million	2022 £ million
Items in the course of collection from credit institutions	**23.7**	21.7
Items in the course of collection from non-credit institutions	**4.1**	4.5
Collateral placed at central clearing houses	**77.5**	525.1
Collateral placed with credit institutions	**96.4**	130.6
Amounts due from the British Business Bank	**7.9**	21.3
Total other advances	**209.6**	703.2

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

10. Fair value of financial assets

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

Bank	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2023					
Debt securities at amortised cost	**2,070.0**	**–**	**–**	**2,070.0**	**2,124.2**
Loans and advances to customers	**–**	**–**	**35,226.5**	**35,226.5**	**36,245.9**
Financial assets at fair value through other comprehensive income	**356.6**	**–**	**–**	**356.6**	**356.6**
Derivative assets at fair value through profit or loss	**–**	**822.9**	**–**	**822.9**	**822.9**
Hedging derivative assets	**–**	**1,346.9**	**–**	**1,346.9**	**1,346.9**
At 31 December 2022					
Debt securities at amortised cost	1,935.1	–	–	1,935.1	1,951.6
Loans and advances to customers	–	–	36,294.1	36,294.1	38,050.0
Financial assets at fair value through other comprehensive income	509.5	–	–	509.5	509.5
Derivative assets at fair value through profit or loss	–	1,158.7	–	1,158.7	1,158.7
Hedging derivative assets	–	1,565.9	–	1,565.9	1,565.9

Company	Level 1 £ million	Level 2 £ million	Level 3 £ million	Total fair value £ million	Total carrying value £ million
At 31 December 2023					
Debt securities at amortised cost	**2,070.0**	**–**	**–**	**2,070.0**	**2,124.2**
Loans and advances to customers	**–**	**–**	**35,226.5**	**35,226.5**	**36,245.9**
Financial assets at fair value through other comprehensive income	**356.6**	**–**	**–**	**356.6**	**356.6**
Derivative assets at fair value through profit or loss	**–**	**806.7**	**–**	**806.7**	**806.7**
Hedging derivative assets	**–**	**1,346.9**	**–**	**1,346.9**	**1,346.9**
At 31 December 2022					
Debt securities at amortised cost	1,935.1	–	–	1,935.1	1,951.6
Loans and advances to customers	–	–	36,294.1	36,294.1	38,050.0
Financial assets at fair value through other comprehensive income	509.5	–	–	509.5	509.5
Derivative assets at fair value through profit or loss	–	1,073.2	–	1,073.2	1,073.2
Hedging derivative assets	–	1,565.9	–	1,565.9	1,565.9

Notes to the financial statements

Loans and liquid assets (continued)

10. Fair value of financial assets (continued)

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

The Bank provides loans at both fixed and variable rates. Fair value is principally estimated by discounting anticipated cash flows (including interest at contractual rates) at market rates for similar loans offered by the Bank and other financial institutions. Certain loans secured on residential properties are made at a fixed rate for a limited period, typically two to five years, after which the loans revert to the relevant variable rate. The fair value of such loans is estimated by reference to the market rates for similar loans of maturity equal to the remaining fixed interest rate period. During 2022, a significant increase in market interest rates had the effect of reducing the fair value of loans and advances to customers relative to their carrying amount. This discount reduced at December 2023 reflecting the reduction in market rates relative to December 2022.

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

Notes to the financial statements

Income

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

Accounting policies relevant to recognising income

(e) Interest income and expense

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

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

The effective interest rate is calculated on initial recognition of the financial asset or liability, estimating the future cash flows after considering all the contractual terms of the instrument but not future credit losses. The calculation includes all amounts paid or received by the Bank that are an integral part of the overall return, direct incremental transaction costs related to the acquisition, issue or disposal of a financial instrument and all other premiums or discounts. Reversionary interest is only included in the assessment of the effective interest rate on customer deposits, which includes certain savings 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	2023 £ million	2022 £ million
Interest and similar income		
Interest income calculated using the effective interest method:		
Cash, cash balances at central banks and other demand deposits	**231.9**	64.7
Financial assets at fair value through other comprehensive income	**6.5**	6.8
Debt securities at amortised cost	**53.5**	30.7
Loans to credit institutions	**10.2**	2.8
Loans and advances to customers	**1,271.4**	1,018.0
	1,573.5	1,123.0
Derivative financial instruments	**368.6**	108.7
Total interest and similar income	**1,942.1**	1,231.7
Interest and similar expense		
Interest expense calculated using the effective interest method:		
Borrowings from central banks	**(206.3)**	(94.1)
Customer deposits	**(344.5)**	(67.4)
Debt securities in issue	**(179.8)**	(51.7)
Subordinated liabilities	**(10.3)**	(10.3)
Lease liabilities	**(1.5)**	(1.3)
Other financial liabilities	**(58.7)**	(15.2)
	(801.1)	(240.0)
Derivative financial instruments	**(119.0)**	(10.0)
Total interest and similar expense	**(920.1)**	(250.0)
Net interest income	**1,022.0**	981.7

Included within interest and similar income is £23.8 million (2022: £14.0 million) in respect of impaired financial assets.

12. Net fee and commission income

Bank	2023 £ million	2022 £ million
Fee and commission income		
Bank accounts	**43.3**	51.7
Credit and debit card fee income	**63.1**	60.4
Insurance commission income	**8.8**	8.6
Other	**14.0**	14.8
	129.2	135.5
Fee and commission expense	**(21.2)**	(21.3)
Net fee and commission income	**108.0**	114.2

13. Other operating income

Bank	2023 £ million	2022 £ million
Migration related income	**14.1**	5.9
Rental income	**0.4**	0.6
Other income	**–**	0.1
Total other operating income	**14.5**	6.6

Migration related income comprises insurance recoveries of post migration losses of £14.1 million (2022: £3.0 million), and a migration related VAT recovery of £nil (2022: £2.9 million) following the finalisation of the matter during 2022.

Notes to the financial statements

Charges

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

Accounting policies relevant to recognising charges

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

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

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

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

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

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

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

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

Notes to the financial statements

Charges (continued)

14. Operating expenses

Bank	2023 £ million	2022[1][2] £ million
Staff costs:		
Wages and salaries	**245.4**	231.5
Social security costs	**26.7**	26.8
Other pension costs	**33.3**	30.4
Severance costs[3]	**24.5**	4.9
Other staff costs	**8.8**	10.4
Total staff costs	**338.7**	304.0
Total premises expenses	**34.6**	32.7
Other administrative expenses:		
IT servicing and licence costs[4]	**240.7**	206.5
Regulatory, legal and consultancy costs	**63.9**	[1]58.3
Marketing	**27.8**	26.4
Other expenses[5]	**48.5**	[2]54.0
Total administrative expenses	**754.2**	681.9
Fraud and operational losses	**29.5**	[2]33.6
Conduct costs	**0.4**	[2]37.2
Regulatory fine	**–**	[1]48.7
Other	**1.8**	[1]2.1
Total other operating expenses	**31.7**	121.6
Depreciation of property and equipment	**33.4**	34.7
Depreciation of right of use asset	**16.1**	17.3
Amortisation of intangible assets	**17.5**	14.0
Total depreciation and amortisation	**67.0**	66.0
Total operating expenses	**852.9**	869.5

(1) Regulatory, legal and consultancy costs for 2022 were previously reported as £109.1 million. In order to align with the current year presentation, £50.8 million has been reclassified to other operating expenses (comprising the regulatory fine of £48.7 million and £2.1 million of other).

(2) Other expenses for 2022 were previously reported as £124.8 million. Again, to align with the current year presentation, £70.8 million has been reclassified to other operating expenses (comprising conduct costs of £37.2 million and £33.6 million of fraud and operational losses).

(3) Includes strategic restructuring costs of £23.0 million.

(4) Includes an accelerated charge of £23.8 million from a related party IT supplier arising from IT obsolescence following investment by TSB in internal processes to serve customers and improve efficiency, partially offset by the receipt of investment tax credits in respect of IT development expenditure incurred in previous years (see note 25 on page 79 under the heading Operational IT costs).

(5) Primarily comprises the costs of operational contracts, and non-staff contractors.

Notes to the financial statements

Charges (continued)

14. Operating expenses (continued)

Notable expenses

Notable items are identified separately by management as they have an undue impact on the overall cost trend and their highlighting ensures the key drivers of cost trends can be better understood.

Bank	2023 £ million	2022 £ million
Staff costs	**23.0**	–
Premises expenses	**1.2**	–
IT servicing and licence costs	**1.6**	–
Regulatory, legal and consultancy costs	**0.7**	–
Depreciation	**2.2**	–
Strategic restructuring costs[(1)]	**28.7**	–
IT servicing and license costs[(2)]	**23.8**	–
Migration related[(3)]	**(2.7)**	51.1
Conduct costs	**(1.0)**	28.6
Other notable costs[(4)]	**4.1**	11.5
Total notable expenses	**52.9**	91.2

(1) Restructuring activity designed to support the delivery of TSB's strategy and deliver future cost reductions.

(2) Accelerated charges from a related party IT supplier. Investment by TSB in internal processes to serve customers and improve efficiency led to obsolescence in the supplier's IT equipment, the cost of which was borne by TSB (see note 25 on page 79 under the heading of Operational IT costs).

(3) Amounts reported for 2023 largely comprise of the release of cost accruals following the completion of regulatory investigations in to the 2018 IT migration. Amounts reported for 2022 comprised of £48.7 million for the regulatory fine in relation to the 2018 IT migration and reported in other operating expenses, and £2.4 million of additional post migration costs reported in regulatory, legal and consultancy costs.

(4) Other notable items comprise of staff costs of £1.8 million (2022: £5.9 million), premises expenses of £1.3 million (2022: £(0.2) million, depreciation of £0.8 million (2022: £4.8 million) and other expenses of £0.2 million (2022: £1.0 million).

Average number of employees

The monthly average number of employees on a headcount basis during the year was 5,568 (2022: 5,592), all of whom were employed in the UK. Remuneration paid to key management personnel (note 25(i)) is included in staff costs.

Share based compensation

Staff costs include £1.9 million (2022: £3.3 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.

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 2023, £7.5 million (2022: £8.3 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 25(iii) on page 79.

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:

Bank	2023 £ million	2022 £ million
Fees payable to the Company's auditor for the audit of the Company's annual accounts [(1)]	**3.7**	**3.6**
Fees payable to the Company's auditor and its associates for other services:		
Audit of the accounts of subsidiaries	**0.1**	**0.1**
Audit related assurance services [(2)]	**1.1**	**1.3**
Total fees payable to TSB's auditors	**4.9**	**5.0**

(1) Additional fees of £0.1 million were incurred in 2023 in respect of the 2022 audit (2022: £0.2 million incurred in 2022 in respect of the 2021 audit) and are not captured in the above table.

(2) Primarily fees payable to the Company's auditor for the audit of the half year financial statements, as required by the Bank's ultimate parent company, Sabadell.

Notes to the financial statements

Charges (continued)

15. Directors' emoluments

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

	2023 £ 000	2022 £ 000
Remuneration paid to Directors in respect of qualifying services	**3,840**	3,714
Employer contributions to pension schemes (including cash paid in lieu)	**167**	174
Cash paid under long term incentive arrangements	**–**	319
Total	**4,007**	4,207

The aggregate remuneration of the highest paid director was £1,860,047 (2022: £1,815,139) for qualifying services as a TSB director.

The table below presents the number of Directors who:

	2023 Number	2022 Number
Exercised share options in the parent company, Sabadell	**–**	–
Received Sabadell shares under long term incentive schemes	**–**	–
Accrued pension benefits under defined contribution pension schemes	**–**	–

16. Taxation

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

Bank	2023 £ million	2022 £ million
UK corporation tax		
Current tax		
Current tax charge on profit for the year	**(29.4)**	(33.4)
Adjustment in respect of prior year	**(0.2)**	(0.8)
Current tax charge	**(29.6)**	(34.2)
Deferred tax (note 17)		
Utilisation of carried forward trading losses	**(33.3)**	(36.7)
Origination and reversal of temporary differences:		
Change in UK corporation tax rate	**–**	(12.3)
Accelerated capital allowances	**(1.0)**	0.6
Adjustments in respect of prior years	**4.1**	4.4
Other	**(2.3)**	(2.3)
Deferred tax charge	**(32.5)**	(46.3)
Taxation charge	**(62.1)**	(80.5)

Notes to the financial statements

Charges (continued)

16. Taxation (continued)

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

Bank	2023 £ million	2022 £ million
Profit before taxation	**235.5**	181.1
Taxation charge at applied UK corporation tax rate of 27.75% (2022: 27.0%)	**(65.4)**	(48.9)
Factors affecting charge:		
Disallowed costs	**(5.1)**	(26.4)
Adjustments in respect of prior years	**3.9**	3.6
Taxable profits not subject to the bank surcharge	**2.8**	2.0
Non-taxable items	**1.7**	1.4
Changes to UK corporation tax rates	**–**	(12.3)
Other	**–**	0.1
Taxation charge	**(62.1)**	(80.5)

The applied UK corporation tax rate for 2023 was 27.75% (2022: 27%) and comprises of the main UK corporation tax rate and the bank surcharge. The main UK corporation tax rate was 19% until April 2023, when it was increased to 25%. The bank surcharge was 8% (and applicable to taxable profits of banks in excess of £25 million) until April 2023. Thereafter, it was reduced to 3% (and applicable to taxable profits in excess of £100 million).

The decrease in disallowed costs was due to 2022 primarily including the £48.7 million of regulatory fines in respect of the handling of the 2018 migration of data and IT systems and £33.6 million of conduct charges (see note 30 on page 81).

The effect of the change in UK corporation tax rates in 2022 reflected the substantive enactment in February 2022 of a reduction in the bank surcharge rate from 8% to 3%, effective from April 2023. This resulted in a £12.3 million reduction in the value of deferred tax assets, with a corresponding deferred tax charge recognised in the 2022 statement of comprehensive income.

17. Deferred tax assets

The movement in deferred tax assets is as follows:

	Bank 2023 £ million	Bank 2022 £ million	Company 2023 £ million	Company 2022 £ million
At 1 January	**64.5**	122.6	**64.5**	122.6
Income statement charge (note 16)	**(32.5)**	(46.3)	**(32.5)**	(46.3)
Amounts charged to shareholder's equity:				
Movements in fair value reserve	**0.3**	6.4	**0.3**	6.4
Movements in cash flow hedge reserve	**10.9**	(18.2)	**10.9**	(18.2)
At 31 December	**43.2**	64.5	**43.2**	64.5

Deferred tax assets are comprised as follows:

	Bank 2023 £ million	Bank 2022 £ million	Company 2023 £ million	Company 2022 £ million
Deferred tax arising on carried forward trading losses	**22.0**	54.9	**22.0**	54.9
Deferred tax in respect of the transition to IFRS 9	**10.8**	13.4	**10.8**	13.4
Deferred tax arising on cash flow hedge reserve	**(4.9)**	(15.8)	**(4.9)**	(15.8)
Revaluations of financial assets at fair value through other comprehensive income	**2.6**	2.3	**2.6**	2.3
Other temporary differences	**12.7**	9.7	**12.7**	9.7
Total deferred tax assets	**43.2**	64.5	**43.2**	64.5

Notes to the financial statements

Managing financial risk

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

Accounting policies relevant to managing financial risk

(j) Derivative financial instruments and hedge accounting

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

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

Hedge accounting

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

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

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, changes in the fair value of the hedged item attributable to the hedged risk are no longer recognised in the income statement. The cumulative adjustment that has been made to the carrying amount of the hedged item is amortised to the income statement 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 *Financial assets at amortised cost:*	**2023 Exposure £ million**	**2023 Credit Quality**	**2022 Exposure £ million**	**2022 Credit Quality**
Cash, cash balances at central banks and other demand deposits:	**5,897.3**		5,238.8	
Cash	***89.2***	***Not Rated***	*87.9*	*Not rated*
Balances with central banks	***5,802.2***	***AA-***	*5,141.2*	*AA-*
On demand deposits	***5.9***	***At least BBB-***	*9.7*	*At least BBB*
Debt securities[(1)]	**2,124.2**	**At least AA-**	1,951.6	At least AA-
Loans and advances to customers	**36,245.9**	**Note 18(ii)**	38,050.0	Note 18(ii)
Loans and advances to central banks and credit institutions[(2)]	**328.0**		303.5	
Loans and advances to credit institutions	***192.0***	***A+***	*159.2*	*A+*
Loans and advances to central banks	***136.0***	***AA-***	*144.3*	*AA-*
Other advances	**209.6**		703.2	
Government institutions	***7.9***	***AA-***	*21.3*	*AA-*
Other advances	***201.7***	***Not rated***	*681.9*	*Not rated*
Financial assets at fair value through other comprehensive income	**356.6**	**AA-**	509.5	AA-
Financial assets subject to expected credit loss requirements	**45,161.6**		46,756.6	
Derivative financial assets[(3)]	**2,169.8**		2,724.6	
Total on-balance sheet financial assets	**47,331.4**		49,481.2	
Lending commitments	**5,812.6**	**Note 8**	5,617.4	Note 8
Maximum credit risk exposure	**53,144.0**		55,098.6	

(1) Includes £592.3 million (2022: £546.2 million) rated AAA.
(2) Loans and advances to credit institutions of £192.0 million (2022: £159.2 million) are not included in the Company totals.
(3) The net uncollateralised derivative balance was £20.4 million (2022: £409.3 million) 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

At 31 December 2023	Stage 1 £ million	Stage 2 £ million	Stage 3 £ million	POCI[(1)] £ million	Total £ million
Loans and advances to customers					
Retail – mortgages	**30,281.1**	**3,267.9**	**404.6**	**93.9**	**34,047.5**
Retail – unsecured	**1,462.3**	**325.4**	**92.0**	**1.0**	**1,880.7**
Business banking	**372.5**	**91.6**	**11.5**	**–**	**475.6**
Gross customer lending balances	**32,115.9**	**3,684.9**	**508.1**	**94.9**	**36,403.8**
ECL on drawn balances	**(55.9)**	**(76.9)**	**(78.0)**	**(1.0)**	**(211.8)**
Net customer lending balance	**32,060.0**	**3,608.0**	**430.1**	**93.9**	**36,192.0**
Valuation adjustments[(2)]					**53.9**
Net balance sheet carrying value					**36,245.9**
Allowance for credit impairment losses					
Retail – mortgages	**14.4**	**22.4**	**19.6**	**1.0**	**57.4**
Retail – unsecured[(3)]	**37.9**	**52.3**	**57.5**	**–**	**147.7**
Business banking	**3.6**	**2.2**	**0.9**	**–**	**6.7**
Total	**55.9**	**76.9**	**78.0**	**1.0**	**211.8**
Coverage (%)					
Retail – mortgages	**0.05%**	**0.69%**	**4.84%**	**1.06%**	**0.17%**
Retail – unsecured	**2.59%**	**16.07%**	**62.50%**	**–**	**7.85%**
Business banking	**0.97%**	**2.40%**	**7.83%**	**–**	**1.41%**
Total	**0.17%**	**2.09%**	**15.35%**	**1.05%**	**0.58%**

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

(1) Purchased or originated as credit impaired.
(2) Comprises accrued interest of £20.3 million (2022: £18.8 million) and effective interest rate adjustments of £33.6 million (2022: £43.9 million).
(3) Excludes expected credit impairment provisions for off balance sheet exposures of £10.4 million (2022: £13.9 million). These comprise of stage 1 of £4.6 million (2022: £4.4 million), stage 2 of £4.0 million (2022: £7.2 million), stage 3 of £1.8 million (2022: £2.2 million), and POCI of £nil (2022: £0.1 million).

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

The tables below summarise the movements between stages for loans and advances to customers.

TSB drawn balances	Stage 1		Stage 2		Stage 3		POCI		Total	
	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million
At 1 January 2023	33,737.1	(38.1)	3,866.8	(96.0)	472.1	(63.3)	109.3	(0.6)	38,185.3	(198.0)
Changes reflected in impairment losses:	(1,065.4)	(19.1)	(493.2)	(12.3)	(136.1)	(34.4)	(14.4)	(0.4)	(1,709.1)	(66.2)
Increases due to originations	5,727.6	(18.8)	220.5	–	40.8	–	4.7	–	5,993.6	(18.8)
Decreases due to repayments	(6,793.0)	5.0	(713.7)	3.0	(176.9)	6.1	(19.1)	1.0	(7,702.7)	15.1
Changes in credit risk[1]	–	(5.3)	–	(15.3)	–	(40.5)	–	(1.4)	–	(62.5)
Amounts written off	–	–	–	–	(72.4)	52.4	–	–	(72.4)	52.4
Transfers between stages[2] [3]	(555.8)	1.3	311.3	31.4	244.5	(32.7)	–	–	–	–
To stage 1	4,786.9	(17.2)	(4,766.4)	16.9	(20.5)	0.3	–	–	–	–
To stage 2	(5,292.1)	17.5	5,361.6	(20.8)	(69.5)	3.3	–	–	–	–
To stage 3	(50.6)	1.0	(283.9)	35.3	334.5	(36.3)	–	–	–	–
At 31 December 2023	32,115.9	(55.9)	3,684.9	(76.9)	508.1	(78.0)	94.9	(1.0)	36,403.8	(211.8)
At 1 January 2022	34,280.5	(59.0)	2,583.9	(74.4)	502.4	(55.4)	124.8	(0.8)	37,491.6	(189.6)
Changes reflected in impairment losses:	1,266.4	9.1	(331.6)	(40.1)	(162.7)	(19.3)	(15.5)	0.2	756.6	(50.1)
Increases due to originations	8,671.7	(20.4)	183.3	(1.1)	32.4	(0.1)	8.2	–	8,895.6	(21.6)
Decreases due to repayments	(7,405.3)	3.4	(514.9)	4.9	(195.1)	4.8	(23.7)	(0.2)	(8,139.0)	12.9
Changes in credit risk[1]	–	26.1	–	(43.9)	–	(24.0)	–	0.4	–	(41.4)
Amounts written off	(0.3)	–	(0.7)	–	(61.9)	41.7	–	–	(62.9)	41.7
Transfers between stages[2] [3]	(1,809.5)	11.8	1,615.2	18.5	194.3	(30.3)	–	–	–	–
To stage 1	3,412.5	(16.9)	(3,367.6)	16.7	(44.9)	0.2	–	–	–	–
To stage 2	(5,149.5)	27.7	5,219.9	(30.9)	(70.4)	3.2	–	–	–	–
To stage 3	(72.5)	1.0	(237.1)	32.7	309.6	(33.7)	–	–	–	–
At 31 December 2022	33,737.1	(38.1)	3,866.8	(96.0)	472.1	(63.3)	109.3	(0.6)	38,185.3	(198.0)

Retail – mortgages

	Stage 1		Stage 2		Stage 3		POCI		Total	
	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million
At 1 January 2023	31,812.9	(14.0)	3,366.8	(26.2)	366.8	(13.3)	108.5	(0.6)	35,655.0	(54.1)
Changes reflected in impairment losses:	(1,086.4)	1.5	(414.5)	0.9	(91.2)	(5.0)	(14.6)	(0.4)	(1,606.7)	(3.0)
Increases due to originations	4,258.7	(5.2)	10.1	–	10.6	–	1.9	–	4,281.3	(5.2)
Decreases due to repayments	(5,345.1)	2.8	(424.6)	1.3	(101.8)	4.0	(16.5)	1.0	(5,888.0)	9.1
Changes in credit risk	–	3.9	–	(0.4)	–	(9.0)	–	(1.4)	–	(6.9)
Amounts written off	–	–	–	–	(0.8)	(0.3)	–		(0.8)	(0.3)
Transfers between stages	(445.4)	(1.9)	315.6	2.9	129.8	(1.0)	–	–	–	–
To stage 1	4,185.0	(7.5)	(4,171.8)	7.2	(13.2)	0.3	–	–	–	–
To stage 2	(4,608.5)	5.4	4,664.3	(7.0)	(55.8)	1.6	–	–	–	–
To stage 3	(21.9)	0.2	(176.9)	2.7	198.8	(2.9)	–	–	–	–
At 31 December 2023	30,281.1	(14.4)	3,267.9	(22.4)	404.6	(19.6)	93.9	(1.0)	34,047.5	(57.4)
At 1 January 2022	32,182.5	(10.4)	2,121.1	(18.9)	406.8	(8.4)	123.4	(0.8)	34,833.8	(38.5)
Changes reflected in impairment losses:	1,144.3	(4.5)	(210.9)	(6.1)	(97.3)	(5.2)	(14.9)	0.2	821.2	(15.6)
Increases due to originations	7,045.6	(7.3)	7.1	–	9.0	–	4.3	–	7,066.0	(7.3)
Decreases due to repayments	(5,901.3)	0.5	(218.0)	0.3	(106.3)	2.2	(19.2)	(0.2)	(6,244.8)	2.8
Changes in credit risk	–	2.3	–	(6.4)	–	(7.4)	–	0.4	–	(11.1)
Amounts written off	–	–	–	–	–	–	–	–	–	–
Transfers between stages	(1,513.9)	0.9	1,456.6	(1.2)	57.3	0.3	–	–	–	–
To stage 1	2,518.7	(3.0)	(2,479.1)	3.0	(39.6)	–	–	–	–	–
To stage 2	(3,984.7)	3.7	4,046.1	(5.3)	(61.4)	1.6	–	–	–	–
To stage 3	(47.9)	0.2	(110.4)	1.1	158.3	(1.3)	–	–	–	–
At 31 December 2022	31,812.9	(14.0)	3,366.8	(26.2)	366.8	(13.3)	108.5	(0.6)	35,655.0	(54.1)

Notes are shown under the table on the following page.

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

Retail – unsecured	Stage 1		Stage 2		Stage 3		POCI		Total	
	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million
At 1 January 2023	1,486.9	(17.9)	398.3	(68.3)	72.4	(49.2)	0.8	–	1,958.4	(135.4)
Changes reflected in impairment losses:	69.2	(22.6)	(70.1)	(12.4)	(6.3)	(29.4)	0.2	–	(7.0)	(64.4)
Increases due to originations	1,418.8	(13.1)	189.7	–	29.5	–	2.8	–	1,640.8	(13.1)
Decreases due to repayments	(1,349.6)	2.0	(259.8)	1.7	(35.8)	2.0	(2.6)	–	(1,647.8)	5.7
Changes in credit risk	–	(11.5)	–	(14.1)	–	(31.4)	–	–	–	(57.0)
Amounts written off	–	–	–	–	(70.7)	52.1	–	–	(70.7)	52.1
Transfers between stages:	(93.8)	2.6	(2.8)	28.4	96.6	(31.0)	–	–	–	–
To stage 1	462.9	(8.9)	(460.0)	8.9	(2.9)	–	–	–	–	–
To stage 2	(528.6)	10.7	536.0	(12.4)	(7.4)	1.7	–	–	–	–
To stage 3	(28.1)	0.8	(78.8)	31.9	106.9	(32.7)	–	–	–	–
At 31 December 2023	1,462.3	(37.9)	325.4	(52.3)	92.0	(57.5)	1.0	–	1,880.7	(147.7)
At 1 January 2022	1,622.8	(42.5)	300.9	(51.9)	65.5	(46.1)	1.4	–	1,990.6	(140.5)
Changes reflected in impairment losses:	166.7	14.3	(125.0)	(36.0)	(11.9)	(13.9)	(0.6)	–	29.2	(35.6)
Increases due to originations	1,591.6	(11.9)	162.9	(0.8)	22.0	(0.1)	3.9	–	1,780.4	(12.8)
Decreases due to repayments	(1,424.9)	2.5	(287.9)	4.0	(33.9)	2.3	(4.5)	–	(1,751.2)	8.8
Changes in credit risk	–	23.7	–	(39.2)	–	(16.1)	–	–	–	(31.6)
Amounts written off	(0.3)	–	(0.6)	–	(60.5)	40.7	–	–	(61.4)	40.7
Transfers between stages:	(302.3)	10.3	223.0	19.6	79.3	(29.9)	–	–	–	–
To stage 1	647.4	(11.7)	(644.3)	11.5	(3.1)	0.2	–	–	–	–
To stage 2	(926.8)	21.2	933.9	(22.8)	(7.1)	1.6	–	–	–	–
To stage 3	(22.9)	0.8	(66.6)	30.9	89.5	(31.7)	–	–	–	–
At 31 December 2022	1,486.9	(17.9)	398.3	(68.3)	72.4	(49.2)	0.8	–	1,958.4	(135.4)

Business banking	Stage 1		Stage 2		Stage 3		POCI		Total	
	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million	Gross £ million	ECL £ million
At 1 January 2023	437.3	(6.2)	101.7	(1.5)	32.9	(0.8)	–	–	571.9	(8.5)
Changes reflected in impairment losses:	(48.2)	2.0	(8.6)	(0.8)	(38.6)	–	–	–	(95.4)	1.2
Increases due to originations	50.1	(0.5)	20.7	–	0.7	–	–	–	71.5	(0.5)
Decreases due to repayments	(98.3)	0.2	(29.3)	–	(39.3)	0.1	–	–	(166.9)	0.3
Changes in credit risk	–	2.3	–	(0.8)	–	(0.1)	–	–	–	1.4
Amounts written off	–	–	–	–	(0.9)	0.6	–	–	(0.9)	0.6
Transfers between stages:	(16.6)	0.6	(1.5)	0.1	18.1	(0.7)	–	–	–	–
To stage 1	139.0	(0.8)	(134.6)	0.8	(4.4)	–	–	–	–	–
To stage 2	(155.0)	1.4	161.3	(1.4)	(6.3)	–	–	–	–	–
To stage 3	(0.6)	–	(28.2)	0.7	28.8	(0.7)	–	–	–	–
At 31 December 2023	372.5	(3.6)	91.6	(2.2)	11.5	(0.9)	–	–	475.6	(6.7)
At 1 January 2022	475.2	(6.1)	161.9	(3.6)	30.1	(0.9)	–	–	667.2	(10.6)
Changes reflected in impairment losses:	(44.6)	(0.7)	4.3	2.0	(53.5)	(0.2)	–	–	(93.8)	1.1
Increases due to originations	34.5	(1.2)	13.3	(0.3)	1.4	–	–	–	49.2	(1.5)
Decreases due to repayments	(79.1)	0.4	(9.0)	0.6	(54.9)	0.3	–	–	(143.0)	1.3
Changes in credit risk	–	0.1	–	1.7	–	(0.5)	–	–	–	1.3
Amounts written off	–	–	(0.1)	–	(1.4)	1.0	–	–	(1.5)	1.0
Transfers between stages:	6.7	0.6	(64.4)	0.1	57.7	(0.7)	–	–	–	–
To stage 1	246.4	(2.2)	(244.2)	2.2	(2.2)	–	–	–	–	–
To stage 2	(238.0)	2.8	239.9	(2.8)	(1.9)	–	–	–	–	–
To stage 3	(1.7)	–	(60.1)	0.7	61.8	(0.7)	–	–	–	–
At 31 December 2022	437.3	(6.2)	101.7	(1.5)	32.9	(0.8)	–	–	571.9	(8.5)

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

In addition, the movement in expected credit loss provisions in respect of off balance sheet exposures is shown in note 30.

Performance overview
Gross loans balances decreased by £1,781.5 million to £36,403.8 million (2022: £38,185.3 million), reflecting the challenging UK mortgage lending market, where gross lending was approximately 30% lower than in 2022.

Stage 1 gross customer lending balances decreased by £1,621.2 million to £32,115.9 million (2022: £33,737.1 million), consistent with the overall decrease including a net transfer to stage 2 of £505.2 million reflected the more challenging economic outlook. Included in net transfers to stage 2 are PMAs of £1,878.0 million, largely to capture the effects of the affordability PMA (see note 8 on page 47).

Stage 2 gross customer lending balances decreased by £181.9 million to £3,684.9 million (2022: £3,866.8 million) driven by ongoing loan repayments by customers, partially offset by the above net transfer in to stage 2 from stage 1.

Stage 3 gross customer lending balances increased by £36.0 million to £508.1 million (2022: £472.1 million), primarily driven by increases in Retail - mortgages and Retail - unsecured, partially offset by a reduction in Business banking reflecting a reduction in gross balances in this portfolio.

Gross loans written off during 2023 of £72.4 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

	2023 £ million	2022 £ million
Income statement charge reported in allowance for credit impairment losses:		
Increases due to originations[(1)]	**18.8**	21.6
Decreases due to repayments[(1)]	**(15.1)**	(12.9)
Charge/(credit) due to changes in credit risk[(1)]	**62.5**	41.4
Release to income statement of allowance associated with gross carrying amounts written off[(1)]	**(52.4)**	(41.7)
Other amounts charged to impairment losses in the income statement:		
Gross carrying amounts written off to income statement	**72.4**	62.9
Recoveries of amounts previously written off	**(11.9)**	(14.4)
Other amounts charged to the income statement	**(2.5)**	0.8
Impairment losses on financial assets at amortised cost	**71.8**	57.7
Impairment losses on financial assets at amortised cost	**71.8**	57.7
Impairment credit on credit impairment provisions in respect of loan commitments	**(3.5)**	(2.8)
Impairment losses per income statement	**68.3**	54.9

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

(iv) Stage 2 balances

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

At 31 December 2023	PD Deterioration £ million	Performing Forborne £ million	>30DPD £ million	Total £ million
Gross customer lending balances				
Retail – mortgages	**3,074.4**	**55.8**	**137.7**	**3,267.9**
Retail – unsecured	**303.8**	**4.6**	**17.0**	**325.4**
Business banking	**74.5**	**0.2**	**16.9**	**91.6**
Total	**3,452.7**	**60.6**	**171.6**	**3,684.9**
Allowance for credit impairment losses				
Retail – mortgages	**19.9**	**0.4**	**2.1**	**22.4**
Retail – unsecured	**44.6**	**0.5**	**7.2**	**52.3**
Business banking	**2.0**	**–**	**0.2**	**2.2**
Total	**66.5**	**0.9**	**9.5**	**76.9**

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

(v) Stage 3 balances

	2023		2022	
Stage 3	Gross loans £ million	ECL £ million	Gross loans £ million	ECL £ million
Credit impaired - not in a cure period	**284.4**	**(45.6)**	220.5	(35.9)
Credit impaired - in the cure period that precedes transfer to stage 2	**223.7**	**(32.4)**	251.6	(27.4)
Total stage 3	**508.1**	**(78.0)**	472.1	(63.3)

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

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

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

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

	Gross loans					Allowance for credit impairment losses				
2023	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
Retail – mortgages										
Excellent quality	29,760.3	16.5	–	2.3	29,779.1	13.1	–	–	–	13.1
Good quality	477.3	287.1	–	47.6	812.0	1.1	1.0	–	–	2.1
Satisfactory quality	34.3	990.5	–	14.3	1,039.1	0.2	2.4	–	–	2.6
Lower quality	4.6	532.4	–	–	537.0	–	2.7	–	–	2.7
Below standard	4.6	1,441.4	404.6	29.7	1,880.3	–	16.3	19.6	1.0	36.9
	30,281.1	3,267.9	404.6	93.9	34,047.5	14.4	22.4	19.6	1.0	57.4
Retail – unsecured										
Excellent quality	699.8	20.5	5.4	0.1	725.8	6.7	1.1	3.2	–	11.0
Good quality	603.2	151.1	11.0	0.1	765.4	18.1	13.6	6.4	–	38.1
Satisfactory quality	148.8	98.4	11.4	0.6	259.2	11.0	17.5	6.1	–	34.6
Lower quality	6.0	16.9	2.8	–	25.7	1.0	4.4	1.5	–	6.9
Below standard	4.5	38.5	61.4	0.2	104.6	1.1	15.7	40.3	–	57.1
	1,462.3	325.4	92.0	1.0	1,880.7	37.9	52.3	57.5	–	147.7
Business banking										
Excellent quality	130.7	–	–	–	130.7	0.7	–	–	–	0.7
Good quality	228.7	0.5	–	–	229.2	2.5	–	–	–	2.5
Satisfactory quality	10.5	59.3	–	–	69.8	0.4	1.4	–	–	1.8
Lower quality	–	2.3	–	–	2.3	–	0.1	–	–	0.1
Below standard	2.6	29.5	11.5	–	43.6	–	0.7	0.9	–	1.6
	372.5	91.6	11.5	–	475.6	3.6	2.2	0.9	–	6.7
Total										
Excellent quality	30,590.8	37.0	5.4	2.4	30,635.6	20.5	1.1	3.2	–	24.8
Good quality	1,309.2	438.7	11.0	47.7	1,806.6	21.7	14.6	6.4	–	42.7
Satisfactory quality	193.6	1,148.2	11.4	14.9	1,368.1	11.6	21.3	6.1	–	39.0
Lower quality	10.6	551.6	2.8	–	565.0	1.0	7.2	1.5	–	9.7
Below standard	11.7	1,509.4	477.5	29.9	2,028.5	1.1	32.7	60.8	1.0	95.6
	32,115.9	3,684.9	508.1	94.9	36,403.8	55.9	76.9	78.0	1.0	211.8
Off balance sheet commitments										
Excellent quality	4,803.1	56.9	8.0	0.5	4,868.5	3.7	0.5	1.0	–	5.2
Good quality	424.0	307.8	4.4	13.3	749.5	0.7	1.9	0.4	–	3.0
Satisfactory quality	99.7	48.2	2.9	0.2	151.0	0.2	1.1	0.2	–	1.5
Lower quality	2.8	5.0	0.4	7.4	15.6	–	0.1	–	–	0.1
Below standard	0.5	13.4	14.1	–	28.0	–	0.4	0.2	–	0.6
Total	5,330.1	431.3	29.8	21.4	5,812.6	4.6	4.0	1.8	–	10.4

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

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

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

Notes to the financial statements

Managing financial risk (continued)

18. Credit risk (continued)

(vii) Collateral held as security for financial assets

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

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

					2023					2022
LTV of Retail – mortgages	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%	**21,661.1**	**3,091.3**	**341.9**	**87.2**	**25,181.5**	25,087.0	3,169.4	331.5	101.8	28,689.7
70% to 80%	**4,587.1**	**118.5**	**39.7**	**5.3**	**4,750.6**	4,404.1	151.7	25.9	5.0	4,586.7
80% to 90%	**3,244.4**	**44.5**	**15.4**	**0.9**	**3,305.2**	2,087.0	34.8	5.2	0.5	2,127.5
90% to 100%	**780.4**	**9.8**	**4.6**	**0.4**	**795.2**	227.9	3.9	2.1	0.3	234.2
Greater than 100%	**8.1**	**3.8**	**3.0**	**0.1**	**15.0**	6.9	7.0	2.1	0.9	16.9
Retail - mortgages	**30,281.1**	**3,267.9**	**404.6**	**93.9**	**34,047.5**	31,812.9	3,366.8	366.8	108.5	35,655.0

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

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

For business banking lending, collateral primarily consists of first charges over commercial and residential property. Where collateral is held, lending decisions are predominantly based on an obligor's ability to repay from normal business operations rather than reliance on any collateral provided. Collateral values are assessed at the time of loan origination and reassessed if there is observable evidence of distress of the borrower. In respect of the £266.3 million (2022: £378.8 million) of Bounce Back Loan Scheme loans, TSB benefits from a 100% guarantee from the British Business Bank under the terms of the scheme rules (amounts recoverable under this guarantee are shown in note 9 on page 48).

Financial assets at fair value through profit or loss (not subject to expected credit loss requirements)
Derivative financial assets of £2,170.4 million (2022: £2,725.9 million) are largely cash collateralised interest rate swaps transacted through central clearing houses. The effect of the collateralisation is shown in note 21 on page 74 under the heading Offsetting financial assets and financial liabilities.

(viii) Forbearance and loan modifications

TSB operates a number of schemes to assist borrowers who are experiencing financial difficulties. Forbearance solutions may offer relief in the form of reductions to contractual payments including freezes to interest payments, and for customers who have longer term financial difficulties, term extensions and capitalisation of arrears. TSB applies the European Banking Authority definition of forbearance and at 31 December 2023, forborne loans were £424.5 million (2022: £352.1 million), of which £282.2 million (2022: £238.1 million) were credit impaired. At 31 December 2023, the allowance for loan losses held in respect of forborne loans was £58.4 million (2022: £49.7 million).

During 2023 gross balances of £52.1 million (2022: £41.5 million) in respect of unsecured loans were subject to modification of the original terms through the temporary freezing of customer interest obligations. At the time, the loans were categorised as either stage 2 or 3 and the allowance for expected credit losses was measured at lifetime expected credit loss. These resulted in modification losses of £2.3 million (2022: £2.0 million).

Notes to the financial statements

Managing financial risk (continued)

19. Liquidity risk

Definition and exposure

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

Sources of funding

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

Risk appetite

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

Measurement and monitoring

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

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

Bank and Company At 31 December 2023	On demand £ million	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	No contractual maturity £ million	Total Carrying Value £ million
Financial liabilities measured at amortised cost:								
Customer deposits	29,779.7	99.0	185.2	2,336.3	2,364.1	–	–	34,764.3
Repurchase agreements	–	–	–	–	–	–	–	
Borrowings from central banks	–	52.9	–	5.0	4,000.0	–	–	4,057.9
Debt securities in issue	–	–	518.4	–	900.0	2,245.7	–	3,664.1
Subordinated liabilities	–	–	–	–	277.7	–	–	277.7
Lease liabilities	–	–	–	1.5	14.5	109.0	–	125.0
Other financial liabilities	298.5	14.8	31.3	136.5	612.2	129.1	–	1,222.4
Derivative liabilities at fair value through profit or loss	–	4.8	12.3	50.7	659.0	255.3	–	982.1
Hedging derivative liabilities	–	4.2	0.4	17.6	275.7	20.8	–	318.7
Total financial liabilities	**30,078.2**	**175.7**	**747.6**	**2,547.6**	**9,103.2**	**2,759.9**	**–**	**45,412.2**
Financial assets at amortised cost:								
Cash, cash balances at central banks and demand deposits	5,897.3	–	–	–	–	–	–	5,897.3
Debt securities	–	9.4	3.3	2.2	604.3	1,505.0	–	2,124.2
Loans and advances to customers	637.6	258.4	304.3	1,295.3	5,604.3	28,146.0	–	36,245.9
Loans and advances to credit institutions(1)	192.0	–	–	–	–	–	–	192.0
Loans and advances to central banks	–	–	–	–	–	–	136.0	136.0
Other advances	27.7	0.9	16.5	19.8	141.4	1.3	2.0	209.6
Financial assets at fair value through other comprehensive income	–	0.6	0.4	0.5	–	355.1	–	356.6
Derivative assets at fair value through profit or loss(2)	–	18.9	24.5	58.2	586.0	135.3	–	822.9
Hedging derivative assets	–	15.8	20.2	71.0	346.2	893.7	–	1,346.9
Total financial assets	**6,754.6**	**304.0**	**369.2**	**1,447.0**	**7,282.2**	**31,036.4**	**138.0**	**47,331.4**

(1) Loans and advances to credit institutions of £192.0 million are not included in the Company totals.

(2) Derivative assets at fair value through profit or loss include £16.2 million in 1-5 years that are not included in the Company totals.

Notes to the financial statements

Managing financial risk (continued)

19. Liquidity risk (continued)

Bank and Company At 31 December 2022	On Demand(1) £ million	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	No contractual maturity £ million	Total Carrying Value £ million
Financial liabilities measured at amortised cost:								
Customer deposits	33,180.4	48.8	149.3	1,555.9	1,403.8	–	–	36,338.2
Repurchase agreements	–	360.0	–	–	–	–	–	360.0
Borrowings from central banks	–	35.6	–	502.7	5,000.0	–	–	5,538.3
Debt securities in issue	–	–	6.6	–	1,449.0	499.9	–	1,955.5
Subordinated liabilities	–	–	0.1	–	265.3	–	–	265.4
Lease liabilities	–	–	–	0.1	24.6	121.2	–	145.9
Other financial liabilities	76.4	20.5	61.6	213.4	743.1	205.1	–	1,320.1
Derivative liabilities at fair value through profit or loss	–	–	4.5	58.5	867.2	322.2	–	1,252.4
Hedging derivative liabilities	–	1.3	0.5	8.9	285.5	5.3	–	301.5
Total financial liabilities	33,256.8	466.2	222.6	2,339.5	10,038.5	1,153.7	–	47,477.3
Financial assets at amortised cost:								
Cash, cash balances at central banks and demand deposits	5,238.8	–	–	–	–	–	–	5,238.8
Debt securities	–	8.4	41.8	2.2	432.3	1,466.9	–	1,951.6
Loans and advances to customers	602.7	258.8	331.8	1,426.6	6,389.3	29,040.8	–	38,050.0
Loans and advances to credit institutions(2)	159.2	–	–	–	–	–	–	159.2
Loans and advances to central banks	–	144.3	–	–	–	–	–	144.3
Other advances	57.1	–	26.8	55.5	153.5	2.2	408.1	703.2
Financial assets at fair value through other comprehensive income	–	0.7	0.8	0.5	–	507.5	–	509.5
Derivative assets at fair value through profit or loss(3)	–	1.3	2.4	82.1	805.0	267.9	–	1,158.7
Hedging derivative assets	–	16.0	23.7	69.0	442.3	1,014.9	–	1,565.9
Total financial assets	6,057.8	429.5	427.3	1,635.9	8,222.4	32,300.2	408.1	49,481.2

(1) Financial liabilities and financial assets have been further analysed between on demand and up to 1 month to align with the current year presentation.

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

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

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 2023	On Demand[1] £ million	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	No contractual maturity £ million	Total £ million
Liabilities								
Financial liabilities measured at amortised cost:								
Customer deposits	**29,778.1**	**175.6**	**219.3**	**2,409.5**	**2,502.8**	**–**	**–**	**35,085.3**
Repurchase agreements	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Borrowings from central banks	**–**	**52.9**	**–**	**155.3**	**4,171.0**	**–**	**–**	**4,379.2**
Debt securities in issue	**–**	**–**	**560.0**	**138.9**	**3,501.8**	**–**	**–**	**4,200.7**
Subordinated liabilities	**–**	**–**	**2.6**	**7.8**	**312.9**	**–**	**–**	**323.3**
Lease liabilities	**–**	**0.3**	**4.6**	**13.3**	**54.0**	**81.7**	**–**	**153.9**
Other financial liabilities	**298.5**	**14.8**	**31.3**	**136.5**	**612.2**	**129.1**	**–**	**1,222.4**
Loan commitments	**3,913.9**	**36.3**	**144.2**	**1,431.8**	**62.2**	**224.2**	**–**	**5,812.6**
Total non-derivative financial liabilities	**33,990.5**	**279.9**	**962.0**	**4,293.1**	**11,216.9**	**435.0**	**–**	**51,177.4**
Net settled derivatives	**–**	**47.8**	**115.4**	**397.9**	**669.7**	**94.8**	**–**	**1,325.6**
Total financial liabilities	**33,990.5**	**327.7**	**1,077.4**	**4,691.0**	**11,886.6**	**529.8**	**–**	**52,503.0**

At 31 December 2022	On demand £ million	Up to 1 month £ million	1-3 months £ million	3-12 months £ million	1-5 years £ million	Over 5 years £ million	No contractual maturity £ million	Total £ million
Liabilities								
Financial liabilities measured at amortised cost:								
Customer deposits	33,178.0	72.1	171.7	1,585.0	1,468.0	–	–	36,474.8
Repurchase agreements	–	360.0	–	–	–	–	–	360.0
Borrowings from central banks	–	35.6	–	669.6	5,464.6	–	–	6,169.8
Debt securities in issue	–	–	23.2	74.6	1,646.2	509.5	–	2,253.5
Subordinated liabilities	–	–	2.6	7.8	323.2	–	–	333.6
Lease liabilities	–	0.4	4.9	15.6	61.1	72.6	–	154.6
Other financial liabilities	76.4	20.5	61.6	213.4	743.1	205.1	–	1,320.1
Loan commitments	3,905.4	88.0	149.0	1,190.2	56.0	228.8	–	5,617.4
Total non-derivative financial liabilities	37,159.8	576.6	413.0	3,756.2	9,762.2	1,016.0	–	52,683.8
Net settled derivatives	–	20.2	47.8	328.0	1,160.0	146.4	–	1,702.4
Total financial liabilities	37,159.8	596.8	460.8	4,084.2	10,922.2	1,162.4	–	54,386.2

(1) Financial liabilities and financial assets at December 2022 have been further analysed between on demand and up to 1 month to align with the current year presentation.

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 TSB's strategy and ensure that it is able to absorb losses under stressed conditions. Capital risk is managed under a framework where risk appetite is set and approved annually by the Board. A series of metrics is used to monitor capital against early warning indicators with regular reporting in place to update and inform senior management.

	Bank 2023 £ million	Bank 2022 £ million	Company 2023 £ million	Company 2022 £ million
Shareholder's equity	**1,954.6**	1,929.8	**1,950.9**	1,924.7
Regulatory deductions	**(116.0)**	(149.8)	**(116.0)**	(144.7)
Common Equity Tier 1/Total Tier 1 capital	**1,838.6**	1,780.0	**1,834.9**	1,780.0
Tier 2 capital	**325.2**	326.0	**325.2**	326.0
Total capital resources	**2,163.8**	2,106.0	**2,160.1**	2,106.0

Notes to the financial statements

Managing financial risk (continued)

21. Market risk

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

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

Board risk appetite is set against a 12 month view of the sensitivity of net interest income to a 100 basis point, instantaneous, parallel shock to interest rates, for all currencies and maturities. The balance sheet and net interest income is simulated using actual point in time positions combined with the latest forecast assumptions for balances and margins.

At 31 December 2023, 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 £32.7 million (2022: £50.4 million) from a 100bps increase in rates, and a decrease of £27.5 million (2022: £28.7 million) from a 100bps decrease. The measure assumes all interest rates, for all currencies and maturities, move at the same time and by the same amount.

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	2023				2022			
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	**27,592.2**	**822.9**	**(982.1)**	**11.2**	31,652.6	1,158.7	(1,252.4)	(8.1)
Total	**27,592.2**	**822.9**	**(982.1)**	**11.2**	31,652.6	1,158.7	(1,252.4)	(8.1)

Company	2023				2022			
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	**27,592.2**	**806.7**	**(982.1)**	**12.6**	31,652.6	1,073.2	(1,252.4)	(13.2)
Total	**27,592.2**	**806.7**	**(982.1)**	**12.6**	31,652.6	1,073.2	(1,252.4)	(13.2)

Notes to the financial statements

Managing financial risk (continued)

21. Market risk (continued)

Bank and Company Hedging derivative financial instruments	2023 Contract/ notional amount £ million	Assets fair value £ million	Liabilities fair value £ million	Change in fair value used for calculating hedge ineffectiveness £ million	2022 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	**27,227.6**	**1,264.9**	**(315.1)**	**229.6**	22,118.0	1,429.5	(301.5)	971.4
(Cash flow hedges)								
Interest rate and credit risk								
Forward settlement contracts	**–**	**–**	**–**	**(5.9)**	210.0	10.2	–	(8.9)
Interest rate risk								
Interest rate swaps	**644.0**	**82.0**	**(3.6)**	**(28.8)**	884.0	126.2	–	(54.6)
Total	**27,871.6**	**1,346.9**	**(318.7)**	**194.9**	23,212.0	1,565.9	(301.5)	907.9

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 £11.2 million (2022: £(8.1) million loss) should be considered in conjunction with the gain of £0.6 million (2022: £7.1 million gain) from the amortisation of accumulated adjustments on the hedged items for which hedge accounting no longer applies.

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

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

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

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

Notes to the financial statements

Managing financial risk (continued)

21. Market risk (continued)

Hedge accounting overview (continued)

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

Cash flow hedge accounting – floating rate debt securities in issue
Interest rate risk on issued floating rate debt securities in issue is hedged using interest rate swaps that exchange floating rate cash flows for fixed rate cash flows. At 31 December 2023, £644.0 million (2022: £884.0 million) of floating rate debt securities in issue were designated in cash flow hedge relationships, of which cash flows in respect of £105.0 million (2022: £300.0 million) were expected to mature within five years, and cash flows in respect of £539.0 million (2022: £584.0 million) were expected to mature after ten years.

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

Bank and Company 2023	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	**(9,616.9)**	**85.5**	**Customer deposits**	**221.1**	**n/a**
Fixed rate mortgages	Interest rate	**14,486.4**	**(154.9)**	**Loans & adv to customers**	**(370.8)**	**n/a**
Individual hedged risk:						
Subordinated liabilities	Interest rate	**(277.7)**	**22.4**	**Subordinated liabilities**	**12.3**	**n/a**
Debt securities	Interest rate	**356.6**	**–**	**Financial assets at FVOCI**	**(18.1)**	**n/a**
Debt securities	Interest rate	**1,622.8**	**(613.7)**	**Financial assets at amortised cost**	**(74.5)**	**n/a**
					(230.0)	
Cash flow hedges						
Debt securities	Interest rate/credit	**–**	**n/a**	**Financial assets at FVOCI**	**(5.9)**	**–**
Debt securities in issue	Interest rate	**644.0**	**n/a**	**Debt securities in issue**	**(28.8)**	**17.0**
					(34.7)	**17.0**
2022						
Fair value hedges						
Portfolio hedged risk:						
Demand deposits	Interest rate	(6,751.0)	321.3	Customer deposits	276.1	n/a
Fixed rate mortgages	Interest rate	11,598.9	(542.8)	Loans & adv to customers	(461.1)	
Individual hedged risk:						
Subordinated liabilities	Interest rate	(265.4)	34.7	Subordinated liabilities	26.4	n/a
Debt securities	Interest rate	348.4	–	Financial assets at FVOCI	(184.8)	n/a
Debt securities	Interest rate	1,407.5	(688.2)	Financial assets at amortised cost	(631.7)	n/a
					(975.1)	
Cash flow hedges						
Debt securities	Interest rate/credit	161.2	n/a	Financial assets at FVOCI	8.9	10.2
Debt securities in issue	Interest rate	884.0	n/a	Debt securities in issue	54.6	46.1
					63.5	56.3

The amount of fair value hedge adjustments remaining on the balance sheet relating to hedges which have been de-designated is £122.0 million (2022: £119.6 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:	
2023	**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	**0.4**	**–**	Gains from hedge accounting	**n/a**	n/a
Cash flow hedges	Interest rate / credit risk	**–**	**(5.9)**	n/a	**(4.3)**	Other income
Cash flow hedges	Interest rate	**(3.2)**	**(28.8)**	Gains from hedge accounting	**(0.1)**	Other income
		(2.8)	**(34.7)**		**(4.4)**	
2022						
Fair value hedges	Interest rate	(3.7)	–	Gains from hedge accounting	n/a	n/a
Cash flow hedges	Interest rate / credit risk	–	8.9	n/a	(0.5)	Other income
Cash flow hedges	Interest rate	0.8	54.6	Gains from hedge accounting	2.2	Other income
		(2.9)	63.5		1.7	

Losses from hedge accounting in the income statement of £(2.2) million (2022: £4.2 million of gains) comprise hedge ineffectiveness losses of £(2.8) million (2022: £(2.9) million of losses) and £0.6 million of gains (2022: £7.1 million of gains) from amortisation of de-designated cash flow hedges and macro fair value hedge adjustments on hedged items for which hedge accounting had previously been discontinued.

Reconciliation of reserves in respect of hedge accounting

Bank and Company	2023 Fair value reserve £ million	2023 Cash flow hedge reserve £ million	2022 Fair value reserve £ million	2022 Cash flow hedge reserve £ million
Balance as at 1 January	**(6.1)**	**40.4**	11.1	(6.6)
Amounts recognised in other comprehensive income:				
Fair value hedges of interest rate risk				
Changes in fair value of purchased debt securities	**21.8**	**n/a**	(202.1)	n/a
Accumulated fair value hedge adjustment	**(18.1)**	**n/a**	184.8	n/a
	3.7	**n/a**	(17.3)	n/a
Net amounts reclassified to profit or loss	**(4.4)**	**n/a**	(6.3)	n/a
Taxation	**0.3**	**n/a**	6.4	n/a
Cash flow hedges of interest rate and credit risk				
Effective portion of changes in fair value of forward contracts	**n/a**	**(5.9)**	n/a	8.9
Amounts reclassified from reserves to profit or loss	**n/a**	**(4.3)**	n/a	(0.5)
Taxation	**n/a**	**2.7**	n/a	(2.3)
Cash flow hedges of interest rate				
Effective portion of changes in fair value of interest rate swaps	**n/a**	**(28.8)**	n/a	54.6
Amounts reclassified from reserves to profit or loss	**n/a**	**(0.1)**	n/a	2.2
Taxation	**n/a**	**8.2**	n/a	(15.9)
Balance as at 31 December	**(6.5)**	**12.2**	(6.1)	40.4

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 2023	Gross amounts £ million	Amounts offset[2] £ million	Net amounts reported on the balance sheet £ million	Related financial instrument amounts not offset £ million	Cash collateral received/ pledged[1] £ million	Net amount £ million
Derivative financial assets	**2,169.8**	**–**	**2,169.8**	**(1,146.8)**	**(1,002.6)**	**20.4**
Reverse repurchase agreements	**250.0**	**(250.0)**	**–**	**–**	**–**	**–**
	2,419.8	**(250.0)**	**2,169.8**	**(1,146.8)**	**(1,002.6)**	**20.4**
Derivative financial liabilities	**1,300.8**	**–**	**1,300.8**	**(1,146.8)**	**(153.6)**	**0.4**
Repurchase agreements	**250.0**	**(250.0)**	**–**	**–**	**–**	**–**
	1,550.8	**(250.0)**	**1,300.8**	**(1,146.8)**	**(153.6)**	**0.4**
At 31 December 2022						
Derivative financial assets	2,724.6	–	2,724.6	(1,354.5)	(960.7)	409.4
Reverse repurchase agreements	750.0	(750.0)	–	–	–	–
	3,474.6	(750.0)	2,724.6	(1,354.5)	(960.7)	409.4
Derivative financial liabilities	1,553.9	–	1,553.9	(1,354.5)	(198.8)	0.6
Repurchase agreements	1,110.0	(750.0)	360.0	(360.0)	–	–
	2,663.9	(750.0)	1,913.9	(1,714.5)	(198.8)	0.6

Company				Related amounts where set off in the balance sheet is not permitted		
At 31 December 2023	Gross amounts £ million	Amounts offset[2] £ million	Net amounts reported on the balance sheet £ million	Related financial instrument amounts not offset £ million	Cash collateral received/ pledged[1] £ million	Net amount £ million
Derivative financial assets	**2,153.6**	**–**	**2,153.6**	**(1,146.8)**	**(925.7)**	**81.1**
Reverse repurchase agreements	**250.0**	**(250.0)**	**–**	**–**	**–**	**–**
	2,403.6	**(250.0)**	**2,153.6**	**(1,146.8)**	**(925.7)**	**81.1**
Derivative financial liabilities	**1,300.8**	**–**	**1,300.8**	**(1,146.8)**	**(153.6)**	**0.4**
Repurchase agreements	**250.0**	**(250.0)**	**–**	**–**	**–**	**–**
	1,550.8	**(250.0)**	**1,300.8**	**(1,146.8)**	**(153.6)**	**0.4**
At 31 December 2022						
Derivative financial assets	2,639.1	–	2,639.1	(1,354.5)	(849.6)	435.0
Reverse repurchase agreements	750.0	(750.0)	–	–	–	–
	3,389.1	(750.0)	2,639.1	(1,354.5)	(849.6)	435.0
Derivative financial liabilities	1,553.9	–	1,553.9	(1,354.5)	(198.8)	0.6
Repurchase agreements	1,110.0	(750.0)	360.0	(360.0)	–	–
	2,663.9	(750.0)	1,913.9	(1,714.5)	(198.8)	0.6

(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, by counterparty, in order to exclude any over collateralisation. The collateral amount presented includes non-cash collateral received of £76.9 million (2022: £111.1 million) and non-cash collateral pledged of £0.8 million (2022: £0.8 million).

(2) In December 2023, TSB entered into a £250.0 million repurchase agreement that transferred legal title of certain covered bond retained notes in return for cash, together with an agreement to repurchase the assets at a later date and at a predetermined price. Concurrently, TSB entered into a £250.0 million reverse repurchase agreement with the same counterparty as the repurchase agreement. The reverse repurchase agreement transferred legal title of certain UK gilts to TSB, in return for the payment of cash, together with an agreement for TSB to sell the UK gilts at a later date and at a predetermined price. The repurchase agreement and reverse repurchase agreement mature in 2027.

At 31 December 2022, TSB had entered into £750.0 million of repurchase agreements that transferred legal title of certain Duncan 2022 retained notes in return for cash, together with an agreement to repurchase the assets at a later date and at a predetermined price. Concurrently, TSB entered into £750.0 million of reverse repurchase agreements with the same counterparties as the repurchase agreement. These reverse repurchase agreements transferred legal title of certain UK gilts to TSB, in return for the payment of cash, together with an agreement for TSB to sell the UK gilts at a later date and at a predetermined price. These reverse repurchase agreements matured during 2023.

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 the Bank'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.

In addition, the following accounting policies relate to the consolidated financial statements as a whole.

(p) 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.

(q) Foreign currency translation
The Bank's functional and reporting currency is Sterling. 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.

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 2022	79.4	195.6	412.8	11.1	(6.6)	1,174.1
Net change in fair value reserve	–	–	–	(17.2)	–	–
Net change in cash flow hedging reserve	–	–	–	–	47.0	–
Profit for the year	–	–	–	–	–	100.6
Dividends paid	–	–	–	–	–	(67.0)
At 31 December 2022	**79.4**	**195.6**	**412.8**	**(6.1)**	**40.4**	**1,207.7**
Net change in fair value reserve	**–**	**–**	**–**	**(0.4)**	**–**	**–**
Net change in cash flow hedging reserve	**–**	**–**	**–**	**–**	**(28.2)**	**–**
Profit for the year	**–**	**–**	**–**	**–**	**–**	**173.4**
Dividends paid (note 23)	**–**	**–**	**–**	**–**	**–**	**(120.0)**
At 31 December 2023	**79.4**	**195.6**	**412.8**	**(6.5)**	**12.2**	**1,261.1**

Notes to the financial statements

Other important disclosures (continued)

22. Shareholder's equity (continued)

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 2022	79.4	195.6	412.8	11.1	(6.6)	1,174.1
Net change in fair value reserve	–	–	–	(17.2)	–	–
Net change in cash flow hedging reserve	–	–	–	–	47.0	–
Profit for the year	–	–	–	–	–	95.5
Dividend paid	–	–	–	–	–	(67.0)
At 31 December 2022	**79.4**	**195.6**	**412.8**	**(6.1)**	**40.4**	**1,202.6**
Net change in fair value reserve	–	–	–	**(0.4)**	**–**	**–**
Net change in cash flow hedging reserve	–	–	–	**–**	**(28.2)**	**–**
Profit for the year	–	–	–	**–**	**–**	**174.8**
Dividend paid (note 23)	–	–	–	**–**	**–**	**(120.0)**
At 31 December 2023	**79.4**	**195.6**	**412.8**	**(6.5)**	**12.2**	**1,257.4**

At 31 December 2023, TSB Bank plc had in issue 7,945,000,100 (2022: 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. Dividends

During 2023 the Board approved a dividend policy. This policy seeks the distribution, by way of dividend, of 50 per cent of each year's profit after tax, recommended to be paid as an interim dividend. In determining the actual pay out ratio, the policy requires the Board to seek an appropriate balance between returns to the shareholder and the capital required to support the strategy in the medium term plan, and takes in to account assessment of principal and emerging risks faced by the Bank (as described on pages 9 to 14).

An interim dividend of £120 million (2022: £67 million) (0.843 pence per ordinary share) was paid in December 2023, representing a 69% pay out ratio. This enhanced dividend reflects an assessment as to TSB's current and future capital requirements following the completion of the annual medium term planning exercise. Based on this exercise, the Board expects to revert to a pay out ratio of around 50% of profit after tax in future years. These financial statements reflect this interim dividend.

24. Contingent liabilities

Significant judgement

Conduct
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 (note 30). It is not, however, currently possible to conclude if any regulatory penalty will be levied, or the timing of any potential penalty, and therefore no costs for an estimated penalty have been recognised in these financial statements.

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

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

Notes to the financial statements

Other important disclosures (continued)

25. Related party transactions

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

(i) Key management personnel

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

Bank and Company	2023 £ 000	2022* £ 000
Short term employee benefits	**7,612**	7,641
Post-employment benefits	**546**	676
Other long term awards	**648**	411
Share based payments	**878**	144
Payments for loss of office	**385**	–
Total	**10,069**	8,872

* The comparative amount has been re-presented on the same basis as the current year and excludes £2,139k of awards which vest over a number of years.

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	2023 £ 000	2022 £ 000
Loans		
At 1 January	**1,387**	671
Advances (includes key management personnel appointed during the year)	**98**	838
Interest charged during the year	**18**	16
Repayments made during the year (including key management personnel resigned during the year)	**(90)**	(138)
At 31 December	**1,413**	1,387

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

Bank and Company	2023 £ 000	2022 £ 000
Deposits		
At 1 January	**116**	247
Deposits made during the year (includes key management personnel appointed during the year)	**1,641**	649
Interest expense on deposits	**8**	–
Withdrawals made during the year (including key management personnel resigned during the year)	**(1,193)**	(780)
At 31 December	**572**	116

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

(ii) Transactions and balances with TSB Group companies

Amounts payable to TSB Banking Group plc, the Company's immediate parent company, totalled £124.5 million (2022: £53.9 million) primarily reflecting amounts payable in respect of the 2023 interim dividend of £120.0 million (2022: £67.0 million).

Amounts due from TSB Banking Group Employee Share Trust (EST) totalled £1.6 million (2022: £1.6 million) reflecting an interest free loan to enable the EST to acquire Sabadell shares in respect of the Bank's share based compensation schemes.

Amounts due from structured entity subsidiaries to the Company totalled £205.1 million (2022: £240.3 million) comprising of balances in respect of covered bond and securitisation programmes.

Notes to the financial statements

Other important disclosures (continued)

25. Related party transactions (continued)

(iii) Transactions and balances with Sabadell Group companies

Dividends
As set out in note 23, TSB Bank plc paid an interim dividend of £120.0 million to its parent, TSB Banking Group plc, in December 2023 (December 2022: £67.0 million) which has been reflected in these financial statements.

Operational IT costs
Operating expenses of £70.8 million (2022: £53.9 million) were incurred in respect of services provided by Sabis, TSB's ultimate parent company's IT supplier, under the Outsourced Services Agreement for running and developing the banking platform. The 2023 expense included £23.8 million of accelerated charges, where investment by TSB in internal processes to serve customers and improve efficiency led to obsolescence in Sabis's IT equipment, the cost of which was borne by TSB. At 31 December 2023, the aggregate liability to Sabis was £15.7 million (2022: £6.0 million).

Senior unsecured debt securities
In December 2023, TSB Bank plc issued £200.0 million of floating rate notes, due to mature in December 2028, 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 3.28% payable quarterly in arrears.

In December 2022, TSB Bank plc issued £250.0 million of floating rate notes with a maturity date of December 2026 to its parent company, TSB Banking Group plc, at an issue price of 100% of the principal amount. The notes pay interest at SONIA plus 3.4% payable quarterly in arrears. The Company has the option to redeem these notes in December 2025 and quarterly thereafter, subject to approval of the PRA.

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

Interest expense of £53.0 million (2022: £18.0 million) was recognised and £4.3 million was payable at 31 December 2023 (2022: £2.4 million).

Subordinated liabilities
In March 2021, TSB Bank plc issued £300.0 million fixed-to-floating rate callable subordinated Tier 2 capital notes, due to mature in March 2031, to its parent company, TSB Banking Group plc. These were issued at a price of 100% of the principal amount. The notes pay interest at a fixed rate of 3.449% per annum payable quarterly in arrears. TSB has the option to redeem these notes in March 2026, subject to approval of the PRA. Interest expense of £10.3 million (2022: £10.3 million) was recognised and £0.1 million was payable at 31 December 2023 (2022: £0.1 million).

Economic hedging of share based compensation liability
TSB holds forward purchase agreements with Sabadell to acquire 8.0 million (2022: 9.3 million) Sabadell shares to satisfy estimated requirements under various share based compensation arrangements. At 31 December 2023, this forward agreement had an asset fair value of £0.6 million (2022: asset fair value of £1.3 million) and TSB had received cash collateral from Sabadell of £0.8 million (2022: TSB had received cash collateral from Sabadell of £1.6 million).

Other transactions and balances
Sabadell acts as an intermediary for TSB in respect of international payments. TSB has nostro accounts as a result of this arrangement which had a net balance due from Sabadell of £5.5 million (2022: £9.4 million). Sabadell acts as guarantor to TSB's borrowings under the TFSME. Under this arrangement guarantee fees of £8.5 million (2022: £11.1 million) were recognised and £2.0 million was payable at 31 December 2023 (2022: £2.9 million).

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

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

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

Notes to the financial statements

Other important disclosures (continued)

26. Property and equipment

Bank and Company	Property £ million	Equipment £ million	Property Right of use leasing asset £ million	Total £ million
Cost				
At 1 January 2022	172.5	92.3	230.5	495.3
Additions	20.7	29.1	3.7	53.5
Disposals	(34.4)	(24.7)	(10.9)	(70.0)
Lease term remeasurement (note 27)	–	–	(2.9)	(2.9)
At 31 December 2022	**158.8**	**96.7**	**220.4**	**475.9**
Additions	**29.6**	**5.8**	**1.3**	**36.7**
Disposals	**(3.5)**	**(15.2)**	**(5.0)**	**(23.7)**
Lease term remeasurement (note 27)	**–**	**–**	**(5.9)**	**(5.9)**
At 31 December 2023	**184.9**	**87.3**	**210.8**	**483.0**
Accumulated depreciation				
At 1 January 2022	86.9	38.5	69.6	195.0
Depreciation charge for property and equipment (note 14)	19.0	15.7	–	34.7
Depreciation charge for right of use asset (note 14)	–	–	17.3	17.3
Disposals	(31.0)	(16.0)	(11.6)	(58.6)
At 31 December 2022	**74.9**	**38.2**	**75.3**	**188.4**
Depreciation charge for property and equipment (note 14)	**18.5**	**14.9**	**–**	**33.4**
Depreciation charge for right of use asset (note 14)	**–**	**–**	**16.1**	**16.1**
Disposals	**(2.1)**	**(0.4)**	**(5.9)**	**(8.4)**
At 31 December 2023	**91.3**	**52.7**	**85.5**	**229.5**
Carrying amount				
At 31 December 2022	83.9	58.5	145.1	287.5
At 31 December 2023	**93.6**	**34.6**	**125.3**	**253.5**

Property held for sale totalled £0.1 million (2022: £0.5 million). The net book value represented the recoverable amount and no impairment was required.

27. 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. The tables below set out details of the amounts recognised in the financial statements in respect of leases:

Bank and Company	Property 2023 £ million	Property 2022 £ million
Balance at 1 January	**145.9**	163.5
Additions	**1.3**	3.7
Lease term remeasurement	**(5.9)**	(2.9)
Interest expense for the year	**1.5**	1.3
Lease payments made in the year	**(17.8)**	(19.7)
Carrying amount at 31 December	**125.0**	145.9

Notes to the financial statements

Other important disclosures (continued)

28. Intangible assets

Bank and Company	2023 £ million	2022 £ million
Cost		
At 1 January	**110.7**	94.9
Additions	**28.0**	17.5
Disposals	**–**	(1.7)
At 31 December	**138.7**	110.7
Accumulated amortisation		
At 1 January	**35.1**	22.8
Amortisation charge for the year (note 14)	**17.5**	14.0
Disposals	**–**	(1.7)
At 31 December	**52.6**	35.1
Carrying amount	**86.1**	75.6

29. Other assets

	Bank 2023 £ million	Bank 2022 £ million	Company 2023 £ million	Company 2022 £ million
Prepayments	**41.3**	34.5	**41.3**	34.5
Accrued fee and commission income	**23.5**	21.8	**23.5**	21.8
Amounts recoverable under customer remediation indemnity	**6.9**	9.9	**6.9**	9.9
Other	**20.3**	15.8	**19.3**	14.7
Amounts due from other TSB Group companies (note 25(ii))	**1.6**	1.6	**206.7**	241.9
Total other assets	**93.6**	83.6	**297.7**	322.8

30. Provisions

Bank and Company	Conduct provisions £ million	Restructuring provisions £ million	Credit impairment provisions £ million	Dilapidations provisions £ million	Total £ million
At 1 January 2022	59.5	14.4	16.7	19.6	110.2
Transfers(1)	2.7	–	–	–	2.7
Charge/(credit) to income statement	(2)33.6	5.6	(2.8)	–	36.4
Utilisation	(7.2)	(13.3)	–	(3.8)	(24.3)
At 31 December 2022	**88.6**	**6.7**	**13.9**	**15.8**	**125.0**
Reallocations	**–**	**0.4**	**–**	**(0.4)**	**–**
Charge/(credit) to income statement	**(4.2)**	**(3)24.4**	**(3.5)**	**1.3**	**18.0**
Utilisation	**(60.6)**	**(5.2)**	**–**	**(2.0)**	**(67.8)**
At 31 December 2023	**23.8**	**26.3**	**10.4**	**14.7**	**75.2**

(1) Reflects the reclassification of £2.7 million of amounts reimbursable by third parties as other assets.
(2) Charge to the income statement in 2022 in respect of conduct provisions of £33.6 million relates to the £28.6 million reported as notable conduct charges in note 14 on page 54.
(3) Includes strategic restructuring costs of £23.0 million.

Significant judgement

Restructuring provisions
At 31 December 2023, a provision of £26.3 million (2022: £6.7 million) was carried in respect of restructuring activity designed to support delivery of TSB's strategy. The charge in 2023 of £24.4 million includes estimated costs of employee severance and is expected to be substantially utilised by the end of 2024. A key judgement in recognising this provision charge was in concluding that TSB had a constructive obligation to complete the restructuring and compensate impacted employees.

Notes to the financial statements

Other important disclosures (continued)

30. Provisions (continued)

Conduct provisions
During 2023, the provision for the treatment of customers in TSB's collections and recoveries function reduced to £8.0 million (2023: £69.4 million) reflecting substantial progress in delivering a customer remediation programme.

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

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 pages 45 to 46.

Dilapidation provisions
Dilapidation provision are in respect of estimated payments required to made at the termination of property leases discounted at interest rates consistent with the various lease term end dates.

31. Other liabilities

Bank	2023 £ million	2022 £ million
Amounts payable to Sabadell Group companies (note 25(iii))	**17.7**	6.0
Amounts payable to other TSB Group companies (note 25(ii))	**124.5**	53.9
Accruals and deferred income	**85.6**	106.2
Share based payment liability	**7.5**	8.3
Other creditors	**61.1**	64.4
Total other liabilities	**296.4**	238.8

Company	2023 £ million	2022 £ million
Amounts payable to Sabadell Group companies (note 25(iii))	**17.7**	6.0
Amounts payable to other TSB Group companies (note 25(ii))	**124.5**	53.9
Accruals and deferred income	**85.6**	106.2
Share based payment liability	**7.5**	8.3
Other creditors	**60.7**	64.0
Total other liabilities	**296.0**	238.4

Notes to the financial statements

Other important disclosures (continued)

32. Notes to the consolidated cash flow statement

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

Bank	Borrowings from central banks £ million	Debt securities in issue £ million	Subordinated liabilities £ million	Repurchase agreements £ million	Total Non customer funding £ million
At 1 January 2022	5,501.6	2,199.1	291.8	–	7,992.5
Additional borrowings from central banks	510.0	–	–	–	510.0
Repayment of borrowings from central banks	(510.0)	–	–	–	(510.0)
Repayment of covered bonds	–	(500.0)	–	–	(500.0)
Issue of senior unsecured debt securities	–	700.0	–	–	700.0
Repayment of senior unsecured debt securities	–	(450.0)	–	–	(450.0)
Issue of repurchase agreements	–	–	–	359.9	359.9
Non-cash movements	36.7	6.4	(26.4)	0.1	16.8
At 31 December 2022	**5,538.3**	**1,955.5**	**265.4**	**360.0**	**8,119.2**
Additional borrowings from central banks	**5.0**	**–**	**–**	**–**	**5.0**
Repayment of borrowings from central banks	**(1,500.0)**	**–**	**–**	**–**	**(1,500.0)**
Issue of covered bonds	**–**	**1,750.0**	**–**	**–**	**1,750.0**
Buyback of covered bonds	**–**	**(251.0)**	**–**	**–**	**(251.0)**
Issue of senior unsecured debt securities	**–**	**200.0**	**–**	**–**	**200.0**
Repayment of repurchase agreements	**–**	**–**	**–**	**(359.9)**	**(359.9)**
Non-cash movements[1]	**14.6**	**9.6**	**12.3**	**(0.1)**	**36.4**
At 31 December 2023	**4,057.9**	**3,664.1**	**277.7**	**–**	**7,999.7**

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

Company	Borrowings from central banks £ million	Debt securities in issue £ million	Subordinated liabilities £ million	Repurchase agreements £ million	Total non customer funding £ million
At 1 January 2022	5,501.6	2,199.1	291.8	–	7,992.5
Additional borrowings from central banks	510.0	–	–	–	510.0
Repayment of borrowings from central banks	(510.0)	–	–	–	(510.0)
Repayment of covered bonds	–	(500.0)	–	–	(500.0)
Issue of senior unsecured debt securities	–	700.0	–	–	700.0
Repayment of senior unsecured debt securities	–	(450.0)	–	–	(450.0)
Issue of repurchase agreements	–	–	–	359.9	359.9
Non-cash movements	36.7	6.4	(26.4)	0.1	16.8
At 31 December 2022	**5,538.3**	**1,955.5**	**265.4**	**360.0**	**8,119.2**
Additional borrowings from central banks	**5.0**	**–**	**–**	**–**	**5.0**
Repayment of borrowings from central banks	**(1,500.0)**	**–**	**–**	**–**	**(1,500.0)**
Issue of covered bonds	**–**	**1,750.0**	**–**	**–**	**1,750.0**
Buyback of covered bonds	**–**	**(251.0)**	**–**	**–**	**(251.0)**
Issue of senior unsecured debt securities	**–**	**200.0**	**–**	**–**	**200.0**
Repayment of repurchase agreements	**–**	**–**	**–**	**(359.9)**	**(359.9)**
Non-cash movements[1]	**14.6**	**9.6**	**12.3**	**(0.1)**	**36.4**
At 31 December 2023	**4,057.9**	**3,664.1**	**277.7**	**–**	**7,999.7**

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

Notes to the financial statements

Other important disclosures (continued)

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

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

		Bank 2023 £ million	Bank 2022[(1)] Restated £ million	Company 2023 £ million	Company 2022 £ million
Decrease/(increase) in loans to central banks		**8.3**	(0.7)	**8.3**	(0.7)
Decrease/(increase) in loans and advances to customers		**1,719.2**	(722.5)	**1,719.2**	(722.5)
Decrease/(increase) in other advances		**493.6**	(622.6)	**493.6**	(622.6)
(Increase)/decrease in other assets		**(6.5)**	72.4	**28.6**	(110.7)
(Decrease)/increase in customer deposits		**(1,666.5)**	357.0	**(1,666.5)**	357.0
(Decrease)/increase in other financial liabilities		**(156.4)**	1,126.5	**(156.4)**	1,126.5
(Decrease)/increase in provisions		**(46.5)**	17.6	**(46.5)**	17.6
Decrease in other liabilities		**(11.6)**	(25.4)	**(11.6)**	(25.8)
Change in operating assets and liabilities[(1)(3)]		**333.6**	202.3	**368.7**	18.8
Interest expense on financing activities[(2)]		**398.8**	160.0	**398.8**	160.0
Interest income on investing activities[(2)]		**(60.0)**	(33.2)	**(60.0)**	(33.2)
Net change in derivative financial instruments and fair value adjustments for portfolio hedged risk[(3)]		**147.6**	61.0	**78.3**	146.5
Depreciation and amortisation		**67.0**	66.0	**67.0**	66.0
Impairment losses on loans and advances to customers		**13.8**	57.8	**13.8**	57.8
Other non-cash items[(2)]		**97.4**	(64.2)	**97.4**	(64.2)
Non-cash and other items		**664.6**	247.4	**595.3**	332.9
Analysis of cash and cash equivalents as shown in the balance sheet					
Cash		**89.2**	87.9	**89.2**	87.9
Balances with central banks		**5,802.2**	5,141.2	**5,802.2**	5,141.2
On demand deposits		**5.9**	9.7	**5.9**	9.7
Cash, cash balances at central banks and other demand deposits		**5,897.3**	5,238.8	**5,897.3**	5,238.8
Loans and advances to credit institutions	Note 7	**192.0**	159.2	**–**	–
Total cash and cash equivalents		**6,089.3**	5,398.0	**5,897.3**	5,238.8

(1) The comparative amount has been restated to include loans and advances to credit institutions as cash and cash equivalents. This had the effect of increasing Change in operating assets and liabilities and Total cash and cash equivalents by £103.1 million.

(2) In the prior year, interest expense on financing activities and interest income on investing activities were presented in other non-cash items and have been shown separately to align with the current year presentation.

(3) Net change in derivative financial instruments and fair value adjustments for portfolio hedged risk of £61.0 million (Company: £146.5 million) have been reclassified from Change in operating assets and liabilities to Non-cash and other items to align with the current year presentation.

33. Approval of the consolidated financial statements

These consolidated financial statements were approved by the Board of Directors on 31 January 2024.

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

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

1 Our opinion is unmodified

We have audited the financial statements of TSB Bank plc ("the Company") for the year ended 31 December 2023 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 2023 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 four financial years ended 31 December 2023. 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.

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 2022: ◄►** ***31 December 2023: £211.8 million*** ***(31 December 2022: £198.0 million)*** ***Refer to note 8 (accounting policy and financial disclosures)***	**Subjective estimate** The measurement of ECL on loans and advances to customers involves significant judgements and estimates. A heightened risk of material misstatement of ECL continues to arise in the current year due to the increased judgement and estimation uncertainty as a result of the current macroeconomic environment. At the planning stage, the key areas where we identified greater levels of judgement and therefore increased levels of audit focus in the Group's estimation of ECL were: • **Economic scenarios:** IFRS 9 requires the Group to measure ECL on a forward-looking basis reflecting a range of future economic conditions. Significant management judgement is applied to determine the economic scenarios used, particularly in the context of the current macroeconomic uncertainties, and the probability weightings assigned to each economic scenario. • **Qualitative adjustments:** adjustments to the model-driven ECL results are raised by management to address issues relating to model limitations, model responsiveness or emerging trends including current macroeconomic uncertainties. 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 judgemental modelling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD') and Exposures at Default ('EAD'). The LGD model used in the secured portfolio and the PD models used in the unsecured portfolios are the key drivers of the Group's ECL results and are therefore the most significant judgemental aspects of the Group's ECL modelling approach. The effect of these matters is that, as part of our risk assessment, we determined that the ECL on loans and advances to customers has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. In addition, the disclosures regarding the Group's application of IFRS 9 are key to explaining the key judgements and material inputs to the IFRS 9 results. As a consequence of the inherent estimation uncertainty arising from the economic scenarios and qualitative adjustments elements of the above risk, we have identified both these areas to have a specific fraud risk.	We performed the following audit procedures rather than seeking to rely on the Group's controls because the nature of the balance is such that we would expect to obtain audit evidence primarily through the detailed procedures described: **Test of details:** We recalculated the ECL measured for each of TSB's loan portfolios. We performed sample testing over key inputs, data and assumptions to assess the reasonableness of key aspects of the ECL calculations. **Our economic scenario expertise:** We involved our own economic specialists to assist us in assessing the appropriateness of the Group's methodology for determining the economic scenarios used and the probability weightings applied to them. We assessed the overall reasonableness of the economic scenarios in the context of the current macroeconomic environment by comparing the Group's scenarios to our own modelled scenarios. **Qualitative adjustments:** For each of the significant adjustments to the model-driven ECL results, we assessed the reasonableness of the adjustments by evaluating the key assumptions, inspecting the calculation methodology, tracing a sample of data used back to source data, and recalculating the qualitative adjustments. We also assessed the completeness of qualitative adjustments recognised including in response to model limitations, data limitations and the evolving macroeconomic outlook. **SICR:** We assessed the ongoing effectiveness of the SICR criteria and independently calculated the loans' stage for the Group's loans and advances. **Our financial risk modelling expertise:** We involved our own financial risk modelling specialists in evaluating the Group's IFRS 9 models. We used our knowledge of the Group and our experience of the industry that the Group operates in to independently challenge the appropriateness of the Group's IFRS 9 models. **Assessing transparency:** We evaluated whether the disclosures appropriately reflect and address the uncertainty which exists when determining the Group's overall ECL including in the context of the current macroeconomic environment. As a part of this, we assessed the sensitivity analysis that is disclosed. In addition, we challenged whether the disclosure of the key judgements and assumptions made was sufficiently clear. **Our results** The results of our testing were satisfactory, and we considered the ECL charge and provision recognised and the related disclosures to be acceptable (2022: 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 2022: ◄►**	**Control performance, data capture and integrity** The Group has historical issues with the design and implementation of controls within the Group's general IT control ('GITC') environment, specifically in relation to user access and change management. During 2023 the Group has continued to implement the multi-year IT control remediation project that was established in 2022. The Group's accounting and reporting processes are dependent on automated controls ('ACs', such as, data feeds or automated calculations) enabled by IT systems. These are then supported by GITCs, covering areas such as access and change management and batch processing, which ensure the integrity of the Group's IT systems. There is a risk that, if the GITCs are not effective, inappropriate access could be gained to IT applications and subsequent unauthorised changes made to the application or the related ACs. In addition, GITCs that are not effective could also affect the integrity of data stored on the IT systems and the effectiveness of automated and manual controls that use this data.	Our procedures included: **Risk assessment:** We performed a risk assessment of the GITC environment and the progress being made by the Group on its multi-year IT control remediation project; based on the progress made we concluded to not test GITCs as part of the current year audit **Control testing:** We tested the design and implementation of relevant ACs relating to the posting of journals as required by the auditing standards. **Extended scope:** As a result of the decision made to not test GITCs, we assessed what additional testing procedures were necessary to mitigate any residual risk, including: • Whilst we were not able to rely on the associated GITCs, we decided to continue to place reliance on certain ACs by increasing the frequency with which we manually tested the operation of these ACs subject to audit from once to multiple times throughout the period. • We performed incremental substantive procedures to address the same process risk as the relevant ACs. **Our results:** We identified certain ACs that we could rely on in our audit as a result of the additional testing performed as detailed above. For the remainder, we were not able to rely on the ACs, however, through the performance of the incremental procedures set out above, we have been able to reduce the audit risk relating to IT access, change management and operations to an acceptable level (2022: same). With regard to automated controls, we did not identify any significant deficiencies or material errors in the relevant data elements that we tested (2022: same).

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

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

Materiality for the Group financial statements as a whole was set at £11.0 million (2022: £10.0 million), determined with reference to a benchmark of Group profit before tax (2022: group total revenues), of which it represents 4.6% (2022: 0.89%). The benchmark in the previous period was total revenue. We selected profit before tax as the benchmark in the current period reflecting the continued and forecast profitability of TSB, with profit before tax being the presumed benchmark for banking audits.

Materiality for the parent Company financial statements as a whole was set at £11.0 million (2022: £10.0 million), determined with reference to a benchmark of Company total assets, of which it represents 0.84% (2022: 0.84%).

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 was set at 65% (2022: 65%) of materiality for the financial statements as a whole, which equates to £7.15 million (2022: £6.5 million). We applied this percentage in our determination of performance materiality based on General IT control deficiencies identified in the prior year audit and the Group's ongoing remediation of the IT control environment.

We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.55 million (2022: £0.5 million), in addition to other identified misstatements that warranted reporting on qualitative grounds.

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

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

4 Going concern

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

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

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

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

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

Our conclusions based on this work:

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

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

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

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 and 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’s and parent Company’s channel for “whistleblowing”, as well as whether they have knowledge of any actual, suspected or alleged fraud;
- Reading Board, Board Audit Committee and Risk Committee minutes;
- Considering remuneration incentive schemes and performance targets for management and directors;
- Using analytical procedures to identify any unusual or unexpected relationships; and,
- Discussion with our own forensic professionals regarding the identified fraud risks and the design of the audit procedures planned in response to these.

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

As required by auditing standards, and taking into account possible pressures to meet profit targets and our overall knowledge of the control environment, we perform procedures to address the risk of management override of controls, in particular the risk that Group management may be in a position to make inappropriate accounting entries and the risk of bias in accounting estimates and judgements such as expected credit losses on loans and advances to customers.

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

We also identified a fraud risk related to estimation of expected credit losses, specifically relating to economic scenarios and qualitative adjustments in response to significant estimation that involves subjective judgements or are inherently uncertain.

Further detail in respect of expected credit losses is set out in the key audit matter disclosures in section 2 of this report.

We also performed procedures including:

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

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

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

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

Identifying and responding to risks of material misstatement related to 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 or 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 and its legal form. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and other management and inspection of regulatory and legal correspondence, if any. Therefore if a breach of operational regulations is not disclosed to us or evident from relevant correspondence, an audit will not detect that breach.

For customer conduct matters discussed in note 30, we assessed the disclosures against our understanding, inquiries of internal counsel, external counsel, and inspection of correspondence with the regulator.

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

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

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

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

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

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

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

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

Strategic report and directors' report

Based solely on our work on the other information:

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

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

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

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

We have nothing to report in these respects.

8 Respective responsibilities

Directors' responsibilities

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

Auditor's responsibilities

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

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

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
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31 January 2024

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