

# 2021 Annual Report & Accounts



Mutual and Proud  
Supporting our Members since 1924

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## Our Directors for the year ended 31 December 2021



**SUSAN JEE**  
**CHAIR & CHAIR OF THE NOMINATIONS COMMITTEE**

Joined the Board in December 2014 and became Chair of the Board and Chair of the Nominations Committee at the start of 2021 after being Vice Chair. Susan is a Chartered Accountant and has extensive experience of managing financial and strategic issues as Finance Director under previous roles and currently as a Non-executive Director. Susan has also had extensive experience of pension fund management and is Chair for two large pension schemes.



**STEVE FLETCHER**  
**CHIEF EXECUTIVE**

Joined the Society in January 2018 to become its 5th CEO. Steve has a broad experience of leadership in financial services having worked for Eagle Star, Birmingham Midshires, Woolwich and Barclays Bank. From 2005 Steve held senior leadership roles at Clydesdale and Yorkshire Bank including Retail Director and Head of



**JENNY QUIRKE**  
**CHAIR OF THE AUDIT COMMITTEE**

Jenny is a Chartered Management Accountant with many years of Board level experience in the financial services sector. Jenny joined the board in January 2018 and brings experience of managing organisational change and financial risk management to the Board, having held senior level roles both with a major building society and a high street bank.



**MICHAEL JOYCE**  
**CHAIR OF THE RISK AND COMPLIANCE COMMITTEE**

Joined the Board in September 2019 and Chairs the Risk & Compliance Committee. Mike is a Chartered Certified Accountant and an Associate Member of the Association of Corporate Treasurers. He has extensive experience of managing retail financial services businesses having worked in retail banking for over 25 years, lately as the Commercial Director of Bank of Ireland in the UK. Mike has also held a wide range of senior roles within finance including as a Finance Director bringing a strong background in financial and strategic risk management.



**JUDITH ASPIN**  
**FINANCE DIRECTOR**

Joined the Society in September 2016 and became Finance Director. Judith is a Chartered Accountant and an Associate Member of the Association of Corporate Treasurers. She has extensive knowledge of managing financial risk having held senior positions in Treasury and Finance in a high street bank.



**PAULA DILLON**  
**CHAIR OF REMUNERATION COMMITTEE**

Paula joined the board in January 2021 and became Chair of Remuneration Committee in Nov 2021. She was a commercial real estate lawyer for over 3 decades, acting for developers, investors and financial institutions. She served on the boards of 2 international law firms as well as being vice chair of Opera North and was the first-ever female President of Leeds Chamber of Commerce. Paula is a non-executive of a listed property company and a director of a hotel company.



**JOHN HUGHES**  
**VICE CHAIR & SENIOR INDEPENDENT DIRECTOR**

Joined the Board in April 2014 and became Senior Independent Director in 2021, after a number of years as Chair to the Board. John brings significant experience of strategic planning and risk management to the Board having held a wide range of senior roles within a major building society and a high street bank, most recently as the latter's Managing Director of Retail Banking.

**The Directors have pleasure in presenting their 98th Annual Report & Accounts and annual business statement for the year ended 31st December 2021.**

### Business Objectives and Activities

#### Purpose and Strategy

Vernon Building Society is a regional building society based in Stockport, in the North West of England, with a strategy of innovative product design to meet customers' requirements, supported by personal service and personal underwriting. This strategy is still relevant and was reconfirmed by the Corporate Plan.

Our mission, which defines our brand purpose is to:

- Help Members buy their own home (even if their situation is unconventional) and
- Offer a safe home for Members' savings.

This Purpose will not be delivered without enthusiastic and engaged people and the Society Values encompass the culture at the Vernon. The Values are described below.

**Authentic:** We are down to earth, straightforward, friendly people that keep our promises.

**Personal:** We treat every Member as an individual. We listen first to understand customer needs (even if they're out of the ordinary) in order to find the best outcome for them.

**Empowering:** We put Members first and strive to provide solutions, not rejections.

### Strategic Business Review

#### The economy and market place

The effects of the pandemic have continued in 2021, although the UK largely unlocked from Q2 allowing some normality to return. Since that time, although GDP has not fully recovered, inflation has become a problem due to temporary impacts of fuel costs and shortages of goods. The stamp duty holiday and tapering back to a normal level have led to an increase in activity in the housing market; coupled with people changing their priorities for housing and a lack of supply, house prices have continued to rise markedly. Nationwide reported a year on year increase to 31 December 2021 of 10.4%.

The Government's range of measures to limit the economic damage from the pandemic appears to have been successful with unemployment remaining at low levels and a shortage of lower paid people causing wages to rise.

The Bank of England ('the Bank') held Bank base rate at the historically low level of 0.1% until 16 December 2021 when they increased Base Rate to 0.25%. Rates were increased further to 0.50% on 3 February 2022 and there is a market expectation that rates could increase further in 2022. The Society will address each base rate movement with the consistent approach of balancing the needs of savers, borrowers, and the long term sustainability of the Society.

During the year, the supply of mortgage products in the market reduced initially, particularly those at higher Loan to Value (LTV) which specifically impacted first time buyers. In the savings market, interest rates are still low with some firms not increasing their rates following the base rate movement.

### Our performance

We are pleased to report that, despite the challenges encountered during the year, your Society has delivered a strong financial performance. Throughout the pandemic, we demonstrated commitment to our Members by maintaining a 95% LTV mortgage product for first time buyers rather than following many lenders who totally removed the ability to purchase a home from some Members. We also remained committed to our Buy for Uni product to help parents with a cost effective alternative to student rental costs. Despite competition returning to the mortgage market, we achieved gross mortgage lending of £76.1m for the year. This resulted in net mortgage book growth of 10.1% for the year.

We remain acutely conscious of the need to balance the competing needs of savers and borrowers and have continued to offer a fair rate to savers, maintaining our rates throughout 2021. We are unable to go against market trends or to continually offer market leading rates as this would ultimately impact existing Members by weakening the Society. Nevertheless, we keep our range of savings products under review and aim to provide products that offer sustainable good value to Members when compared with other high street deposit takers.

The results in 2020 were reduced by an increase in provision for potential bad debts as it was early in the pandemic and there was significant uncertainty and impairment indicators. It is pleasing that the vast majority of our Members have returned to normal payments on their mortgages and this additional provision is not required in 2021, resulting in improved profit which will mean that the Society can continue to grow and benefit more Members.

### Key Performance Indicators

	2021	2020	2019	2018
Gross Mortgage Lending	£76.1m	£74.5m	£51.7m	£43.6m
Savings Balances	£339.2m	£319.4m	£283.5m	£274.7m
Profit before Tax	£2,007k	£891k	£560k	£755k
Net Interest Margin	1.84%	1.88%	1.72%	1.77%
Underlying Interest Margin*	1.89%	1.81%	n/a	n/a
Management Expenses Ratio <sup>†</sup>	1.40%	1.49%	1.56%	1.52%
Liquid Asset Ratio	18.2%	19.7%	20.1%	24.4%
Tier 1 Capital Ratio	18.8%	18.3%	20.7%	21.0%

\*During 2020 an accounting adjustment was made in relation to effective interest treatment of redemption charges, this was largely released in 2021 (see the 'Income' section on page 7). This adjustment impacted the NII for both periods and therefore the underlying NII has also been reported in the table above. <sup>†</sup>The management expenses ratio is an expression of total management expenses (administration expenses plus depreciation) as a percentage of mean total assets.

### Gross Mortgage Lending

Loans and advances to customers increased by £28.7m overall in 2021 (£25.4m after the

LOAN PORTFOLIOS	2021		2020	
	£m	LTV%	£m	LTV%
Prime Residential	237.0	31.4	226.3	33.3
BTL	70.5	44.7	54.2	44.7
Commercial	4.1	26.7	5.8	32.2
Provisions	(0.4)		(0.5)	
	<b>311.2</b>		<b>285.8</b>	

application of certain accounting adjustments disclosed within note 16 to the accounts). This growth was in line with our targets for the year. The Society's strong product range supported this growth, allowing it to take advantage of its personal approach with individual underwriting

to understand more complex mortgage cases to grow the book. The Society is a specialist in self-build, holiday BTL, Buy for Uni and Retirement lending where a personal approach is required to understand the customer requirements. As a result, gross residential mortgage lending had another strong year at £76.1m compared to £74.5m in 2020 and total mortgage loans (pre provisions and fair value adjustments for hedge risk) increased by 10.1% from £284.2m to £312.9m.

### Mortgage arrears

The number of mortgages in arrears by 2.5% or more of the loan balance, as a percentage of our mortgage portfolio, has decreased from 0.36% to 0.27%; remaining lower than the industry average of 0.78% (2020: 0.76%; industry data provided by UK Finance).

As at 31 December 2021 there were 6 cases (2020: 8) where payments were 12 months or more in arrears. The capital balances of these loans were £0.5m (2020: £0.6m). The total amount of arrears on these loans was £0.2m (2020: £0.2m).

As at the year-end there were 8 cases (£1.5m of mortgage balances) with concession related arrangements in place (2020: 7 cases, £1.4m of mortgage balances) and no properties in possession (2020: none). There were no exposures being managed by a Law of Property Act receiver (2020: none).

### Funding

The Society is predominantly funded through retail savings with wholesale funding used to diversify funding sources. Retail savings balances increased by £19.8m during 2021 to £339.2m to fund the mortgage book growth during the year. Wholesale exposures increased during the year by £4.1m.

### Liquid Assets

The Society has continued to maintain the majority of the liquid asset holdings in the form of a deposit into the Society's Bank of England Account, supplemented by some high-quality debt securities issued by supranational organisations. The statutory liquidity percentage reported at 31 December 2021 was 16.9% compared to 18.3% in 2020.

The regulatory Liquidity Coverage Ratio (LCR) was 399% (2020: 378%) as at 31 December 2021 (unaudited); comfortably in excess of the minimum regulatory limit set by the PRA of 100%. The Society has no encumbered collateral.

### Profitability

The Society seeks to make sufficient profit to ensure it has enough capital to invest in and grow the business for the benefit of its current and future Members. The higher level of profit this year means that a branch refurbishment programme can be planned and implemented, whilst having sufficient capital for planned growth.

### Capital

The Society's policy is to have a strong capital base to maintain Member confidence and to sustain future growth of the business, as well as protecting against any adverse changes in economic conditions.

The formal Internal Capital Adequacy Assessment Process (ICAAP) assists the Society with its management of capital and is approved by Board at least annually. The risk appetite aims to maintain a specific level above the Total Capital Requirement (TCR) and the capital regime

## Directors' Report for the year ended 31 December 2021 (continued)

incorporates Lending and Business decisions, product pricing, counterparty and concentration risks. The Society operates under the rules set and managed by the PRA and there have been no breaches during the year.

<b>SOCIETY CAPITAL</b>	<b>2021 £m</b>	<b>2020 £m</b>
Common Equity Tier 1 Capital	25.2	23.5
Collective Impairment Allowance	0.3	0.5
<b>Total Capital (Audited)</b>	<b>25.5</b>	<b>24.0</b>
Credit Risk	123.1	118.3
Operational Risk	10.4	10.0
<b>Total Risk Weighted Assets</b>	<b>133.5</b>	<b>128.3</b>
<b>CAPITAL RATIOS</b>	<b>%</b>	<b>%</b>
Tier 1 Ratio	18.8	18.3
Total Capital Ratio	19.0	18.7
Leverage Ratio	6.5	6.5
Gross Capital ratio	7.1	7.2
Free Capital Ratio	6.8	6.8

Further details on the Society's capital position is given in the Pillar 3 disclosures to be published on the Society's website at the same time as these accounts.

Gross capital at 31 December 2021 was £25.2 million (2020: £23.4 million) being 7.14% (2020: 7.18%) of total shares and borrowings.

Free capital, as at the same date, amounted to £24.0 million (2020: £22.2 million) and 6.78% (2020: 6.80%) of total shares and borrowings.

### Income

The Society's net interest margin decreased by 0.04% in 2021 due to establishing the effective interest rate model for Early Redemption Charges. In 2020 an additional £220k of income was credited to the P&L to recognise future early redemption charges, once the model was established in 2021, the £220k was reduced to £20k. Excluding this adjustment, the underlying net interest margin in 2020 was 1.81%, increasing by 0.08% in 2021 to 1.89%. The underlying increase of 0.08% is due to continuing to offer attractive niche mortgage products (such as buy-to-let, self-build and buy-for-uni family assist products) to support our borrowing members through a difficult period, offset by maintaining deposit rates during the low Bank of England base rate environment.

### Other income and charges

The Society earned a net income of £271k in 2021 (2020: incurred a net charge of £159k) relating to 'Other income and charges'. The movement is primarily driven by an increase in the fair value of derivatives held for hedging purposes, as interest rates have risen in anticipation of base rate increases (see note 6 to the financial statements).

### Administrative expenses and depreciation

Administrative expenses and depreciation (together 'management expenses') was similar to last year, increasing to £5.1m for the year (2020: £4.9m), reflecting the Society's care in managing its costs whilst also continuing its ongoing strategy of investing in our people and processes. The increase is mostly associated with salary increases as there were 71.2 FTE (full time equivalent employees) at the end of 2020 and there were 75.6 FTE at the end of 2021, as we have taken on three new apprentices and recruited other key skills consummate with the higher level of new business.

### Impairment charges

There was a decrease in the loan loss provision of £172k (2020: increase of £225k) primarily due to a provision being taken last year to reflect the impact of the pandemic on a number of

mortgage customers within the mortgage book. During the year, the majority of our mortgage customers have managed to return to full payments so this provision is no longer required. The provision remains at an elevated level due to the economic uncertainty, especially with affordability on higher LTV loans due to inflationary pressures from fuel costs in particular.

### Taxation

The Society shows an effective corporation tax rate of 19.88% in 2021, compared to 20.99% in 2020.

### Supplier Payment Policy

For all trade creditors it is the Society's policy to agree the terms of payment at the start of trading with that supplier and to pay in accordance with its contractual and other legal obligations. We recognise the importance of cash flow for all businesses and creditors are paid on average within 15 days of receipt of invoice.

### Principal Risks and Uncertainties

The Society has a policy of managing risk to acceptable levels to maintain member confidence and to allow the achievement of the corporate objectives. There is a formal structure for risk management documented in the Risk Management Framework, which includes risk appetite statements, risk limits, mandates and reporting lines.

2021 proved to be a more settled year, following the exceptional year of 2020, in which additional risks arose which are covered below in the relevant headings. The potential rise in unemployment flagged as a concern for the Society as the Government support packages of mortgage payment deferral and furlough came to an end, have not yet materialised. The Government support packages appear to have worked for our borrowers, so there are no material mortgage losses that have occurred, resulting in a release of some of the provision taken last year. The provision remains at an elevated level due to ongoing uncertainty, in particular with inflation and an expected marked increase in the cost of living.

In terms of our core risks, we would define these as follows:

**Credit Risk:** the primary credit risks relate to commercial, residential, and investment and it is when the customer/counterparty does not repay the Society and the Society's collateral is insufficient to meet the debt obligations. All mortgages are assessed in accordance with core criteria and counterparties have credit limits set by Board. Exposures to this risk are set out in Note 30.

**Interest Rate Risk** This is the risk that the value of the Society's net assets or net interest income falls as a result of a change in interest rates. This risk is managed by a Board approved policy, with reporting of metrics to ALCO and Board. The interest rate sensitivity as at 31 December 2021 is detailed in the market risk section of Note 30.

**Liquidity & Funding Risk** This is the risk of the Society being unable to meet its financial obligations as they fall due, or only at excessive cost. The Board approved Liquidity Policy describes the liquid resources required to be held to manage the risk, and metrics are reported to ALCO and Board.

**Capital & Strategic Risk** These are the risks of holding insufficient capital and failing to achieve our strategic goals. These risks are managed through our governance processes.

**Conduct Risk** This is the risk of customer detriment arising from the Society's business activities. The risk is monitored by a Conduct Risk Policy and dashboard which includes items such as Training and Competency regimes, as well as complaints monitoring.

**Climate Change Risk** This is the risk due to floods and other factors for properties such as energy efficiency which impacts security value. In addition, there can be impacts on the Society's own property. An initial analysis of the book has been completed, and an approach has been developed.

**Operational Risk** This is the risk of loss through inadequate or failed internal processes, people and systems, or from external factors. For the Society this definition includes legal risk, strategic risk and reputational risk. Operational risk also includes the Society's operational resilience plans which set out how it would respond to events that disrupt its business activities, for example a fire or incident at the head office and a failure or attack on the Society's IT systems. Each operational sub-risk is identified and defined and operational events and near misses are captured.

**Operational Resilience** The Society monitors operational resilience and this was impacted through the Covid pandemic by changing working practices, disruption in 3<sup>rd</sup> party services such as valuations, increased customer support and increased staff absence. The Society has remained operationally resilient with, now embedded adaptations, such as employees working from home and reduced branch opening hours.

### Diversity and Inclusion

The Society is committed to being a fair employer, treating everyone equally and promoting a supportive culture of equality, diversity and inclusion.

### Donations

During the year charitable donations worth £11,588 (2020: £10,645) were made. All donations over £200 are detailed below. No contributions were made for political purposes.

CHARITABLE DONATIONS	2021 £	2020 £
St Ann's Hospice	£2,000	
Hawk Green Women's Cricket Team	£1,250	
Together Trust	£1,100	£750
Handy Ladies Feeding the Community	£1,000	
The Garden House, Marple	£850	
Bare Necessities Toiletry Bank	£750	£750
Signpost Stockport for Carers	£750	£600
Hatters Outreach Providing Essentials	£600	£1,000
NK Theatre Arts	£450	
Stockport without Abuse	£450	
Supportability	£450	
Poynton Pedals for All	£300	
Walthew House	£300	£450
Seashell trust	£250	£1,250
Millie's Trust		£1,500
Stockport County Community Foundation		£1,100
The Cherry Tree Project		£850
Stockport Mind		£450
Pure Innovations		£450
Easy Peel Studio CIC		£300
Friends of High Lane and Brookside Parks		£300
Stockport Pride		£250
Mission Christmas	£146	
St Ann's Hospice (Annual calendar competition)	£942	
Hatters Outreach Providing Essentials		£500
Stockport Mind (Annual calendar competition)		£145

During the year a further £10,000 was donated through the Society's annual Community Awards. The 2021 Community Awards was the tenth year the Society has proudly supported invaluable charities and not-for-profit organisations within the Community it serves, donating over £100,000 in that time. The Society made further contributions to vital organisations within the community during the year, such as the donations made through the annual calendar competition.

### Directors

The following persons were Directors of the Society during the year:

#### Non-executive directors

Susan Jee	Chair
John Hughes	Vice Chair & Senior Independent Director
Mike Joyce	Chair of Risk & Compliance Committee
Jenny Quirke	Chair of Audit Committee
Paula Dillon	Chair of Remuneration Committee

#### Executive Directors

Steve Fletcher	Chief Executive
Judith Aspin	Finance Director

All Directors retire on an annual basis and offer themselves for re-election. No Director has any beneficial interest or shares of any connected undertaking of the Society.

### Going Concern

The Board has assessed the going concern of the Society by reviewing medium and long term plans over a detailed 5 year horizon with particular emphasis on examining forecast liquidity, capital and profitability of the Society and the risks to those forecasts through a variety of stress testing scenarios. This horizon is considered appropriate through alignment to the Society's usual forecasting and management reporting allowing robust and continuous assessment of the Society's expected position and principal risks over the time-frame. Active risk management is undertaken to mitigate the Society's principal risks.

The outcome of this review is that the Directors are satisfied that the Society has adequate resources to continue in business and meet their liabilities as they fall due throughout the period of assessment. Accordingly, the Report and Accounts of the Society have been prepared on a going concern basis with no material uncertainties that the going concern basis of accounting is not appropriate.

### Post Balance Sheet Events

There are no post balance sheet events to report.

### Auditor

Mazars LLP were re-appointed as external auditor at the annual general meeting held in April 2021 and have indicated their willingness to remain in office. A resolution to reappoint Mazars LLP as external auditors will be proposed at the annual general meeting of the Society.

### On behalf of the Board

*Susan Jee*

Susan Jee (Feb 24, 2022 12:31 GMT)

**Susan Jee**

Chair

24 February 2022.

## Statement of Directors' Responsibilities in respect of the financial statements for the year ended 31 December 2021

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable Laws and regulations.

The Building Societies Act 1986 ("the Act") requires the directors to prepare Society annual accounts for each financial year. Under that law they have elected to prepare the Society annual accounts in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland.

The annual accounts are required by law to give a true and fair view of the state of affairs of the Society and of the profit or loss of the Society for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable United Kingdom Accounting Standards, comprising FRS 102, have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Society will continue in business.

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

### Directors' responsibilities for accounting records and internal controls

The Directors are also responsible for safeguarding the assets of the Society and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Society's transactions and disclose with reasonable accuracy at any time the financial position of the Society and enable them to ensure that the financial statements comply with the Building Societies Act 1986, Building Societies Building Societies (Accounts and Related Provisions) Regulations 1998 and UK Accounting Standards.

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

So far as each Director is aware, there is no relevant audit information of which the Society's auditors are unaware. Each of the Directors has taken all steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Society's auditors are aware of that information.

On behalf of the Board

*Susan Jee*

Susan Jee (Feb 24, 2022 12:31 GMT)

**Susan Jee**

Chair

24 February 2022

## Introduction

In discharging its responsibilities to be accountable to the Society's Members for the operation of the Society, the Board regards good corporate governance as extremely important. The UK Corporate Governance Code (the Code), issued by the Financial Reporting Council (FRC) in July 2018 is addressed to publicly quoted companies, however, the Society has been mindful of the code to the extent deemed reasonable and appropriate by the Board when establishing and reviewing corporate governance arrangements.

This report outlines the approach taken by the Society and how the Board considers it has demonstrated application of the principles of the Code.

## The Board

The Society recognises that it must be headed by an effective Board which is responsible for the long-term success of the Society.

There is a clear division of responsibilities between the running of the Board and the Executive responsibility for the running of the Society's business. No one individual has unfettered powers of decision and the roles of Chair and Chief Executive are exercised by different people within the Society. The Nominations Committee carries out a review of the independence of Non-Executive Directors. An effective Board should not necessarily be a comfortable place, with challenge, as well as teamwork, being an essential feature. Challenge by Non-Executive Directors is something which is encouraged by the Chair and, where appropriate, training is provided to support the challenge process. A culture of openness exists within the Society and Non-Executive Directors are encouraged to meet with Members of the Executive team.

## Matters Reserved to the Board

The Board's Terms of Reference are reviewed on a regular basis. A schedule is maintained of matters reserved to the Board which includes the following:-

- **Strategy and Management** - determining the overall strategy of the Society including approval of the Corporate Plan, with the responsibility for its implementation delegated to the Executive team; monitoring operational and financial performance in pursuit of the strategy; overseeing and approving the Society's recovery options and resolution pack; monitoring any recovery plan and approving appropriate management actions; and approving budgets, forecasts and major capital expenditure.
- **Culture** - overseeing the Culture and Values of the Society.
- **Financial Reporting and Internal Controls** - approval of annual results; approval of the Annual Report and Accounts including the Directors Report, Report of the Directors on Corporate Governance, and the Remuneration Committee Report; approval of the Pillar 3 disclosures; ratification of the Going Concern statement following review and approval by the Audit Committee; approval of any significant changes in accounting policies or practice, based on the recommendations of the Audit Committee; and ensuring an adequate internal control environment is in existence. The Board delegates oversight of internal controls to the Audit Committee.
- **Risk Management and Regulatory** - ensuring an adequate Risk Management Framework is in place. This includes approval of risk appetite, oversight of risk governance, reviewing the key risks, ensuring the strategy and risk appetite are consistent and reviewing and approving the Society's primary risk management processes including; the Internal Capital Adequacy

Assessment Process (ICAAP), the Internal Liquidity Adequacy Assessment Process (ILAAP), the Corporate Plan and the Recovery Plan. The Board delegates oversight of risk management to the Risk & Compliance Committee, as well as oversight of compliance with regulations, including by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

- **Strengthening Accountability in Banking** – ensuring that the Society meets its obligations under the Senior Managers & Certification Regime (SMCR) including: reviewing at least annually the SMCR framework; maintaining a Management Responsibilities Map for all PRA Prescribed Responsibilities and FCA Business Activities and ensuring all prescribed responsibilities and business activities have been allocated and leading the development of the Society's culture.
- **Board Membership and Senior Management Issues** – approval of changes to the structure, size and composition of the Board, following recommendations from Nominations Committee; and ensuring that adequate succession planning for the Board and senior management is in place following recommendations from Nominations Committee.
- **Appointment and/or re-appointment or removal of the external auditor** to be put to Members for approval, following a recommendation from the Audit Committee.
- **Remuneration** – agreeing the Remuneration Policy for the Directors and other Material Risk Takers (MRTs) following recommendations from the Remuneration Committee.
- **Delegation of Authority** – ratifying the terms of reference for Board Committees and receiving minutes and/or reports from the Chair of the Board Committees.
- **Corporate Governance Matters** – ensuring that a formal evaluation of the effectiveness of the Board is undertaken on an annual basis and considering whether an external assessment using outside consultants as a facilitator is undertaken every three years; determining the independence of Directors; reviewing the Society's overall corporate governance arrangements; and agreeing the policies that manage Director conflicts of interest and other relevant policies.

### Board Changes and Elections/Re-elections

It is recognised that changes need to be made to the Board from time to time and a comprehensive skills requirement assessment and recruitment process is carried out. Directors are elected at the Annual General Meeting annually following the recommendation of the Combined Code.

### Management Information

The Chair is responsible for ensuring that the Directors receive accurate, timely and clear information. Board Members receive meeting packs in advance of each Board meeting. A rolling Board agenda is tabled at each meeting to ensure that all key areas are covered appropriately during the year. Sufficient time is set aside to ensure that constructive discussion and challenge can take place. All Directors have access to independent professional advice, if required, and also access to the services of the Society Secretary.

### Board Committees

The Board has a number of Committees, all of which have their own Terms of Reference, which are reviewed on an annual basis, with further details provided below. The Chair of each

Committee reports to the Board at its subsequent meeting on the matters discussed at each Committee meeting. Similar to the Board, each Committee has carried out a review of its own effectiveness, and where improvement opportunities have been identified, the individual Committees are responsible for tracking action points. These reviews are carried out on an annual basis and the effectiveness review for each Committee is summarised and presented to the Board for review. Information concerning attendances at the meetings is detailed on page 16. Terms of Reference for the Audit Committee, Risk & Compliance Committee, Remuneration Committee and Nominations Committee are available upon request.

### Audit Committee

Details of the Audit Committee are contained in the Audit Committee Report on pages 18 to 20. Through the work of the Audit Committee and Internal Audit during 2021, the Directors have carried out a review of the Society's risk management and internal control systems, covering all material controls, including financial, operational and compliance controls.

### Remuneration Committee

Details of the Remuneration Committee are contained in the Remuneration Committee Report on pages 21 to 24.

### Risk & Compliance Committee

The Society has a Risk & Compliance Committee comprising a minimum of the Committee Chair, another NED and Chief Risk Officer, and which operates within the Terms of Reference agreed by the Board. The Terms of Reference and the effectiveness of Risk & Compliance Committee are reviewed on an annual basis.

The main objectives of Risk & Compliance Committee are summarised as follows:-

- Overseeing the Society's risk management and governance framework and the Society's overall risk profile.
- Oversight of overall risk appetite, risk management strategy and framework, including oversight of both prudential and conduct risk appetites.
- Oversight of compliance with risk policies.
- Review and assessment of the adequacy of risk management information to monitor and control risks.
- Approval of risk management of new initiatives and projects, and in particular the risks those initiatives and projects expose the Society to.
- Consideration and approval of the top risks for the Society including low likelihood, high impact risks; and Approval of stress testing and scenario testing.

Members of Risk & Compliance Committee are Mike Joyce (Committee Chair), Paula Dillon and Victoria Thackstone (CRO).

Risk & Compliance Committee operates to a rolling agenda to ensure it discharges its full responsibilities. It normally meets a minimum of six times a year and in 2021 it met on six occasions.

### Nominations Committee

The Society has a separate Nominations Committee comprising a minimum of the Chair, Vice-Chair and Chief Executive, and which operates within the Terms of Reference agreed by the Board. The Terms of Reference and the effectiveness of Nominations Committee are reviewed on an annual basis.

The main objectives of Nominations Committee are summarised as follows:-

- To oversee the structure of the Board and Board Committees.
- To identify suitable candidates to fill Board vacancies.
- To ensure that the Board has the appropriate balance of skills, diversity and experience; and
- To oversee the Board's succession plan. All key decisions of Nominations Committee, for example, Board appointments, must also be ratified by the full Board.

Members of Nominations Committee are Susan Jee (Committee Chair), John Hughes and Steve Fletcher (CEO).

Nominations Committee operates to a rolling agenda to ensure it discharges its full responsibilities. It meets a minimum of once a year and in 2021 it met on three occasions.

### Appointments to the Board

Nominations Committee follows a stringent recruitment process when making appointments to the Board. This process is tailored to meet the requirements of each particular vacancy and the method of attracting candidates is adapted depending on the nature of the skills required for the vacancy. External consultants and advisers are normally utilised to ensure there is a robust list of suitable candidates with which to fill a vacancy. During the year the Society utilised the services of independent recruitment specialists, Warren Partners, to start the appointment process for a new Non-Executive Director in early 2022 to replace John Hughes who is due to retire.

Whenever a new Director is appointed, the Financial Conduct Authority and Prudential Regulation Authority have the right, for certain key roles, to carry out formal Significant Influence Function (SIF) interviews in order that the Director becomes an Approved Person.

Directors have been issued with Statement of Responsibilities, and Terms of Engagement for Non-Executive Directors, to ensure that all Directors fully understand and comply with their role and the responsibilities of being a Director of the Society.

### Diversity of the Board

The Board recognises and embraces the benefits of having a diverse Board which utilises a range of factors including skills, industry experience, background, race, gender and the other qualities of its Directors. Giving specific regard to gender ratios, there were four female Directors on the Board throughout 2021 (representing 57% of Board Members). It is important to note that all Board appointments are made based on individual competence, skills and expertise measured against identified objective criteria. Appointment is therefore based on merit and the Board has not set any measurable objectives for diversity although the position will be kept under review.

### Re-election to the Board

As per the recommendation of the Combined Code, all Directors should be required to seek election or re-election at the AGM on an annual cycle, the forthcoming one to be held on 28 April 2022. Non-Executive Directors are usually expected to serve more than three years, subject to satisfactory performance evaluations and re-election by Members.

### Independence of Directors

The Terms of Engagement for Non-Executive Directors require that they declare to the Society any other external interests. Nomination Committee carries out an annual review of the independence of Non-Executive Directors, against the criteria set out in the Code.

The last review was carried out by Nominations Committee in 2021 where it was confirmed that the independence requirements in terms of character and judgement were met. The Society recognises that it is good corporate governance to have a Senior Independent Director and John Hughes fulfils this role.

### Assessment of Directors

All Directors are subject to a formal appraisal of their performance on an annual basis. The Chair conducted the appraisals of the Chief Executive and Non-Executive Directors, the Chief Executive conducted the appraisals of the Finance Director, whilst the Senior Independent Director led the appraisal of the Chair.

### Skills and Continuous Development

All Directors are required, as part of their terms of engagement, to follow a process of continuous development to ensure that their skills and experience meet the needs of the Society and the regulatory environment in which it operates. The training and development plans of Non-Executive Directors are reviewed at least annually during their performance appraisal. Nominations Committee oversees the formal induction programme for newly appointed Directors. The Chair oversees the on-going training and development of Non-Executive Directors.

### Relations with Members

Member engagement is at the heart of our strategy and the Society develops relationships with Members on a number of different levels. The first and most obvious is through the AGM voting process where Members are encouraged, as owners of the business, to use their vote and we try to make this process as easy as possible, including the ability to vote online and by post. Understanding what Members think about our products and service is also extremely important. We use customer satisfaction surveys and obtain feedback from different types of product holders.

### Board and Board Committee Membership Attendance Record

The table below sets out the number of meetings attended by Directors during 2021 with the number in brackets representing the maximum number of meetings the Director was eligible to attend. Due to the Covid pandemic meetings were held either in person or by video conference.

Board member	Board	Audit	Remuneration	Nomination	Risk and Compliance
S Jee	10/(10)	-	3/(3)	3/(3)	-
J Hughes	9/(10)	5/(5)	2/(2)	3/(3)	-
J Quirke	10/(10)	5/(5)	-	-	-
M Joyce	10/(10)	-	3/(3)	-	6/(6)
P Dillon	10/(10)	-	1/(1)	-	6/(6)
S Fletcher	10/(10)	-	-	3/(3)	-
J Aspin	10/(10)	-	-	-	-

### Annual General Meeting (AGM)

The AGM provides an opportunity for Members to question the Chair, Chief Executive, Committee Chairs and fellow Directors on the resolutions to be proposed at the meeting, the

## Corporate Governance Report for the year ended 31 December 2021 (continued)

Annual Report and Accounts, and on any other aspect of the Society's business. All Members who are eligible to vote at the Annual General Meeting are encouraged to participate by using their proxy voting form. The use of the online voting system is encouraged and for each vote placed online, the Society will be donating 50p to the Vernon Building Society Community Stars Fund.

All votes are counted by independent scrutineers. As soon as practicable after the AGM, full details of the results of the voting are placed on the Society's website.

On behalf of the Board

*Susan Jee*

Susan Jee (Feb 24, 2022 12:31 GMT)

**Susan Jee** Chair

24 February 2022

**The main function of the Audit Committee is to review and provide assurance to the Board on the integrity of the annual accounts and the effectiveness of the internal control systems including internal financial control.**

### Members of Audit Committee

Jenny Quirke (Committee Chair) and John Hughes (Vice Chair & Senior Independent Director).

The Committee members were selected for appointment by recommendation of the Nomination Committee in consultation with the Audit Committee Chair for their relevant experience.

### Committee meetings

The Committee meets at least four times each year coinciding with key dates in the Society's financial reporting calendar following a rolling schedule of items for discussion, agreed and reviewed on an ongoing basis. Meetings are attended by Audit Committee members with other regular attendees at meetings including the Chief Executive, Finance Director, Chief Risk Officer, representative of Internal Audit and when appropriate a representative of the External Auditors as well as other management, as the Committee feels is appropriate and necessary.

For details of Committee meeting attendance see page 16 of the Annual Report and Accounts. As well as a formal annual meeting, the Audit Committee has an opportunity to meet with the External Auditors at each Audit Committee meeting, without senior management present. These meetings cover matters relating to its remit and any issues arising from audits, including matters required to be discussed by relevant law or regulations.

### Key roles and responsibilities as delegated by the Board

The main function of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities, specifically the ongoing review, monitoring and assessment of:

### Financial Reporting

The Audit Committee's primary role regarding financial reporting is to monitor the integrity of the Annual Report and Accounts of the Society. This responsibility is discharged through:

- review of the Annual Report and Accounts, for completeness and compliance with relevant accounting standards and other regulatory and legal requirements;
- reporting to the Board on the consistency and appropriateness of critical accounting policies and any changes thereto, taking into account the views of the external auditor;
- review and challenge of significant financial reporting judgements, estimates and the actions and judgements of management;
- review of any correspondence from regulators in relation to financial reporting;
- review of the going concern statement and business viability assessment produced by the Finance Director on an annual basis;

The main areas of financial reporting significance considered by the Audit Committee in 2021 were as follows:

- **Commercial and residential loan impairment provisions:** This is inherently an area of accounting estimate and judgement and was particularly so in 2020 given the economic uncertainty following the pandemic. The Society took a prudent approach recognising additional provision for mortgage holders who had taken a payment deferral and using this indicator as a sign of incurred loss. As 2021 has progressed, all except a few mortgages have reverted to normal payment and the additional provision related to the payment deferral indicator has been removed. The loan impairment provisions are agreed by the Society's

Credit Committee and then reported to the Audit Committee. The Audit Committee reviews the level of provisioning through detailed discussion with management on the key judgements and methodology behind impairment calculations. The impact of forbearance in the mortgage portfolios has been considered and appropriate disclosures made in the Annual Report and Accounts. The Committee is satisfied that the additional impairment indicator is removed and the assumptions adopted and models used to calculate provisions over the residential and commercial mortgage books are a fair balance between the upside and downside risks and represent a reasonable assumption.

- **Fair value of derivatives and financial assets:** The Audit Committee is appraised of the Society's derivative and hedge accounting position and strategy and also agrees with the accounting policy for hedging, including disclosures in the Annual Report and Accounts. The Committee has concluded satisfactorily in this area. As a direct result of the Interest Rate Benchmark Reform the swap derivatives currently referencing Libor market rate will transition to referencing the Sonia risk free rate instead, plus a margin as agreed by the International Swaps and Derivatives Association (ISDA). The Society has elected to transition its swap derivatives using the 'ISDA fallback protocol', a process established to manage the implications of a reference rate no longer being available, such as with the withdrawal of Libor. The transition will take place within Q1 2022 when each of the Libor swap contracts next reprices between 31st January to 31 March, onto the Sonia risk free rate plus the agreed margin.
- **Effective Interest Rate accounting:** The Audit Committee approved a highlevel management overlay in the 2020 accounts to represent the Early Redemption Charges (ERCs) which should be included in the Effective Interest rate (EIR) model. Audit Committee have reviewed and approved the ERC EIR model during 2021 which has now been developed and agrees with the accounting policy for EIR, including disclosures in the Annual Report and Accounts. The Committee has concluded satisfactorily in this area.

Preparing the Annual Report and Accounts under the Going Concern assumption requires the Board and Audit Committee to be satisfied about the long-term viability of the Society's business operations, business planning, business management and risk management. Long term liquidity, capital and funding forecasts alongside business viability considerations are assessed formally at the year-end to coincide with the approval of the Annual Report and Accounts. The Audit Committee concluded that the adoption of the Going Concern basis to prepare the accounts is appropriate.

The Committee considers matters raised by the External Auditors and the Committee concluded there were no adjustments proposed that were material to the Annual Report and Accounts.

Having undertaken the above responsibilities and considerations throughout the Society's 2021 financial year the Audit Committee recommended to the Board that approval be given to the audited Annual Report and Accounts and Summary Financial Statements as at 31 December 2021. The Summary Financial Statements make up part of the Annual Review which can be downloaded from the Society's website.

### Internal Controls

The Audit Committee works closely with the Risk & Compliance Committee to ensure that management and staff take appropriate responsibility for departmental internal control. The Audit Committee agrees the audit plan detailing the work to be undertaken by internal audit during the forthcoming year as part of a five year cycle of work following the appointment of Deloitte as internal auditors (see 'Internal Audit' section below).

## Audit Committee Report for the year ended 31 December 2021 (continued)

The Audit Committee is responsible for:

- review of the scope and effectiveness of the Society's internal control systems including Information Technology security and control.
- establishing the scope and frequency of Internal Audit reviews relating to the internal control environment.

### Internal Audit

The Audit Committee is responsible for the appointment and removal of the Internal Auditors, agreeing the internal audit plan and monitoring activity relative to the plan. Internal audit work will focus on key areas of risk and include a review of the Society's processes, evaluate their effectiveness and make recommendation for improvements where appropriate. The Committee approves the Internal Audit budget and is satisfied that the Internal Audit has the appropriate resources. The Committee reviews the effectiveness of the Internal Audit function including conformance with required Standards. Deloitte LLP have been the Society's Internal Auditors during the current and comparative financial years.

The Committee approves and reviews the Internal Audit work programme and results and ensures that Internal Audit maintains sufficient access to the Board, management and the financial records of the Society. The Committee also reviews the responsiveness of management to findings and recommendations made by internal audit.

### External Audit

The Audit Committee is responsible for overseeing the Society's relationship with the External Auditors, Mazars LLP, who were first appointed in 2020.

The audit committee's responsibilities with regards to external audit extends to:

- appointment, reappointment, removal and assessment of independence, objectivity and effectiveness of the External Auditors;
- approval of terms and remuneration in respect of audit services provided;
- annual approval of the Society's use of the External Auditors for non-audit work; and
- consideration of audit quality including reports by the FRC Audit Quality Review Team.

The FRC reviewed the Society's Annual Report & Accounts in 2020 as part of their review of Mazars LLP's audits and the rating was 'Limited Improvements Required', the required improvements have been incorporated into the 2021 audit work.

The Audit Committee assesses annually the qualification, expertise and resources of the External Auditors seeking reassurance on their independence. The External Auditors communicate their formal independence annually and appraise the Audit Committee of policies, processes and monitoring in place for maintaining their independence.

The Audit Committee ensures that non-audit services provided by the External Auditors will not adversely impact the independence and objectivity of the audit firm in performing their duties.

On behalf of the Board

  
Jenny Quirke (Feb 24, 2022 11:28 GMT)

**Jenny Quirke**

Chair of Audit Committee

24 February 2022

## Introduction

This report details the Society's approach to pay for the period from 1 January to 31 December 2021. It sets out the Remuneration Policy and remuneration details for the Executive, Non Executive Directors and Material Risk Takers (MRTs) of the Society and how it applies the principles of the UK Corporate Governance Code relating to remuneration, the Regulators' Remuneration Code and the disclosure requirements arising under the EU Capital Requirements Directive IV (CRD IV). The report is split into three main areas; the Statement by the Chair of the Remuneration Committee, the Report on Remuneration and the Directors' Remuneration Policy.

### i) Statement by the Chair of the Remuneration Committee

The Remuneration Committee operates within the Terms of Reference (ToR) agreed by the Board. The ToR is reviewed annually and was last reviewed in November 2021.

The main objectives of the committee are summarised as follows:

- To ensure a formal and transparent procedure is in place for developing the policy on Non-Executive, Executive and MRTs remuneration and for fixing the remuneration packages of individual Directors;
- To ensure compliance with the Regulators' Remuneration Rules through at least annual review;
- To determine and agree with the Board the framework for Executive and MRTs remuneration and conditions of employment;
- Approval of the Society's Remuneration Policy, Remuneration Committee Reports in the Society's Annual Report and Accounts and Summary Financial Statements, and the remuneration sections of the Society's Pillar 3 disclosure; and
- To consider and make recommendations to the Board on the general framework of employee bonus schemes.

The Board believes remuneration should be sufficient to attract, retain and motivate senior managers to continue to run the Society successfully, whilst avoiding paying more than is necessary for this purpose. The Remuneration Policy, therefore, focuses on rewarding our Executives and MRTs in line with the achievement of our goals set out in the annual Corporate Plan whilst continuing to provide value for money for our Members.

### ii) Composition of the Committee

The Committee comprises solely of Non-Executive Directors who have no personal financial interest in the recommendations. The Chair of the Committee is Paula Dillon, the other members are Susan Jee and Michael Joyce. The Chief Executive and Finance Director (except for items relating to their own remuneration) also attend meetings but are not members of the Committee. During the year the Committee met three times and its activities included:

- Overseeing compliance of the Society's approach to remuneration against the requirements of the Regulators' Remuneration Rules;
- Considering and agreeing pay and benefits for Executive Directors and MRTs, as well as overseeing remuneration matters across the Society;
- Reviewing the performance for the financial year and approving the resulting level of Corporate Bonus to be paid based on achievement of the Corporate Metrics; and
- Consideration of the disclosure requirements for the Remuneration Report including Pillar 3 disclosures.

## Remuneration Committee Report for the year ended 31 December 2021 (continued)

There were no substantial changes relating to Directors' remuneration made during the year and the Society's Remuneration Policy does not include significant performance related variable remuneration. The Society has adopted a simple remuneration structure which is appropriate to its business and is efficient and cost effective in promoting its long term strategy. Transparent salary, other benefits and pension contributions are supplemented by a modest and straightforward Corporate Bonus Scheme that promotes continued involvement in the Society's ongoing success through cumulative performance targets without overemphasising reward based on short term results.

### iii) Report on Remuneration

The Remuneration Policy applied to Executive Director emoluments is consistent to those applied with any other member of staff. The information provided and disclosed is as required under the Building Society (Accounts and Related Provisions) Regulations 1998. There is a requirement under Para 14 of the Society's Rules to have deposits to the value of not less than £1,000 in a Society share account in order to qualify as a Director. This means all Directors are Members of the Society. The Chief Executive is the Society's most highly paid employee and no employee earns more than any Executive Director. For details of other non-Society Board positions held by the Society's Executive Director team and Non-Executive team see the Annual Business Statement on page 60 of the Annual Report and Accounts. None of the Executive Directors retained any remuneration as a result of their non-Society positions.

Executive Directors Remuneration (£'000)		Salary	Annual Bonus	Benefits	Total
S Fletcher	2021	176	17	-	193
	2020	179	18	-	197
J Aspin	2021	143	13	6	162
	2020	134	12	7	153
<b>Total Executive Directors</b>	2021	<b>319</b>	<b>30</b>	<b>6</b>	<b>355</b>
	2020	313	30	7	350
Non-executive Directors Remuneration (£'000)		Salary	Annual Bonus	Benefits	Total
S Jee	2021	44	-	-	44
	2020	30	-	-	30
J Hughes	2021	29	-	-	29
	2020	44	-	-	44
J Quirke	2021	27	-	-	27
	2020	27	-	-	27
M Joyce	2021	30	-	-	30
	2020	28	-	-	28
P Dillon <sup>2</sup>	2021	27	-	-	27
	2020	-	-	-	-
A Murdoch <sup>1</sup>	2021	-	-	-	-
	2020	27	-	-	27
<b>Total Non-executive Directors</b>	2021	<b>157</b>	<b>-</b>	<b>-</b>	<b>157</b>
	2020	156	-	-	156
<b>Total Directors</b>	2021	<b>476</b>	<b>30</b>	<b>6</b>	<b>512</b>
	2020	469	30	7	506

<sup>1</sup> Resigned as Director 31 Dec 2020

<sup>2</sup> Appointed as Director 1 Jan 2021

## Remuneration Committee Report for the year ended 31 December 2021 (continued)

The Committee is responsible for setting the remuneration of the Executive Directors. When setting salary increases for Executive Directors, the Committee considers the level of salary increases across the Society. All employees of the Society receive a basic salary and benefits consistent with market practice and are eligible to participate in the Society's Corporate Bonus Scheme and pension arrangements.

### Remuneration for Executive Directors

Executive Directors' remuneration comprises basic salary, discretionary bonus and pension benefits, the latter is based on a fixed percentage of salary.

Their remuneration level and structure are considered by the Remuneration Committee which meets at least twice a year, with reference to job content and responsibilities, the performance of the individual and salaries in similar organisations. Additionally, the Remuneration Committee considers the achievement of the strategic objectives within the Corporate Plan and the ongoing delivery of the longer-term strategy for the Society when considering any inflationary increases to Executive Directors' salaries.

There are no incentive schemes in place for the Executive Directors. The Remuneration Committee has the discretion to add a bonus payment to the remuneration of the Executive Directors annually aligned with the approach taken for all staff and is as a result of the appraisal process completed each year when achievement of objectives, aligned to the strategic goals of the Society, are reviewed.

The Society does not have a defined benefit final salary pension scheme. The Society ordinarily makes contributions to the private pension arrangements of the Executive Directors, in line with that available to senior colleagues.

### Remuneration of Non-Executive Directors

The remuneration of all Non-Executive Directors is fee based and is reviewed annually by RemCo. They do not participate in any performance pay scheme, pension arrangements or other benefits and do not have service contracts.

The Chair of the Board, Vice Chair and Chair of Risk and Compliance Committee receive higher fees than other Non-Executive Directors in recognition of the additional workload and responsibilities incumbent on those positions

The remuneration of Non-executive Directors is approved following a recommendation from the Chief Executive and Finance Director.

### Directors' service agreements and notice periods

Executive Directors are employed on service agreements which can be terminated by either the Society or the Director giving six months' notice.

Non-Executive Directors do not have service agreements and are re-elected annually. They will generally be expected to serve more than one three-year term.

### Consideration of Member views

The Committee does not consult with the Society's Members on its Remuneration Policy but considers feedback given by Members. The Committee has for a number of years invited

## Remuneration Committee Report for the year ended 31 December 2021 *(continued)*

Members to vote on the receipt of the annual Remuneration Report, and Members have always voted in favour.

### Deferred Remuneration

There was no deferred remuneration during 2021. As the Society's Remuneration Policy does not include significant performance related variable remuneration, no formal ratio between fixed and variable remuneration is relevant.

On behalf of the Board

  
P Dillon (Feb 24, 2022 11:27 GMT)

**Paula Dillon**

Chair of Remuneration Committee

24 February 2022

# Independent auditor's report to the Members of Vernon Building Society for the year ended 31 December 2021

## Opinion

We have audited the financial statements of Vernon Building Society (the 'Society') for the year ended 31 December 2021 which comprise the Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Members' Interests, Cash Flow Statement and notes to the financial statements, including a summary of significant accounting policies.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the state of the Society's affairs as at 31 December 2021 and of its income and expenditure for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Building Society Act 1986 and the regulations made under it.

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of the financial statements" section of our report. We are independent of the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Conclusions relating to going concern

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

Our audit procedures to evaluate the directors' assessment of the Society's ability to continue to adopt the going concern basis of accounting included but were not limited to:

- Undertaking an initial assessment at the planning stage of the audit to identify events or conditions that may cast significant doubt on the Society's ability to continue as a going concern;
- Making enquiries of the directors to understand the period of assessment considered by them, the assumptions they considered and the implication of those when assessing the Society's future financial performance
- Assessing the Society's 5-year Corporate Plan, ICAAP and ILAAP documentation forming the base of their Going Concern assessment;
- Reviewing key assumptions used by the directors including different scenarios considered within their assessment
- Assessing the historical accuracy of forecasts prepared by the directors; and
- Evaluating the appropriateness of the directors' disclosures in the financial statements on going concern.

## Independent auditor's report to the Members of Vernon Building Society for the year ended 31 December 2021 (continued)

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Society's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

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

### Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We summarise below the key audit matter in forming our opinion above, together with an overview of the principal audit procedures performed to address this matter and our key observations arising from those procedures.

This matter, together with our findings, were communicated to those charged with governance through our Audit Completion Report.

Key Audit Matter	How our scope addressed this matter
<p><b>Credit risk - impairment of loans and advances to customers (refer to page 37, accounting policy and page 46 annual accounts disclosures)</b></p> <p>Credit risk is an inherently judgemental area due to the use of subjective assumptions and a high degree of estimation in arriving at the year-end provisions. The total impairment provision of the Society consists of an individual provision on loans with default indicators and a collective provision on the performing portfolio.</p> <p>The Society has limited actual loan loss experience on which to base its impairment assessment on the loan portfolio, resulting in management judgement being applied in determining assumptions to be applied in its assessment.</p> <p>The impairment model is most sensitive to movements in the House Price Index (HPI), Forced Sales Discount (FSD) applied to collateral.</p>	<p>We performed the following procedures:</p> <ul style="list-style-type: none"><li>- Tested the design, implementation and the operating effectiveness, of the key controls operating at the Society in relation to credit processes (loan origination and approval, loan redemptions and arrears monitoring);</li><li>- Checked the accuracy of external data used in the provisioning model (e.g. HPI) and check the relevance of this data based on our understanding of the Society's portfolio;</li><li>- Compared the Society's key assumptions PD and FSD with similar lenders and similar loan portfolio / characteristics, including whether these assumptions are consistent with industry benchmarks, and develop an independent estimate using the Society's model and reasonable assumptions.</li><li>- Analysed the Society's approach and consideration on borrowers' ability to repay as a result of current year impact of COVID-19.</li></ul>

# Independent auditor's report to the Members of Vernon Building Society for the year ended 31 December 2021 (continued)

values and the probability that a loan with default (PD).

The collective model is also sensitive to any changes made to PD such as utilisation of management overlays applied in the prior year.

- Performed sensitivity analysis over the key assumptions on PD, FSD and HPI; and
- Assessed and challenged the modification made to COVID-related overlays to the core PD assumptions applied in 2020.

### Our observations

Based on the audit procedures performed, we found the resulting estimate of the loan impairment provision to be acceptable.

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

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

Overall materiality	£252,000
How we determined it	1% of Net Assets
Rationale for benchmark applied	<p>We consider that net assets is the most appropriate benchmark to use for the Society, whose strategy is to provide mortgages, savings products and other financial services for the mutual benefit of Members and customers and not one of profit maximisation.</p> <p>Further, net asset as a benchmark is supported by the fact that regulatory capital is a key benchmark for management and regulators where net assets, is an approximation of regulatory capital resources.</p>
Performance materiality	<p>Performance materiality is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole.</p> <p>We set performance materiality of £176,400, which represents 70% of overall materiality.</p>
Reporting threshold	<p>We agreed with the directors that we would report to them misstatements identified during our audit above £7,560 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.</p>

As part of designing our audit, we assessed the risk of material misstatement in the financial statements, whether due to fraud or error, and then designed and performed audit procedures

## Independent auditor's report to the Members of Vernon Building Society for the year ended 31 December 2021 (continued)

responsive to those risks. In particular, we looked at where the directors made subjective judgements, such as assumptions on significant accounting estimates.

We tailored the scope of our audit to ensure that we performed sufficient work to be able to give an opinion on the financial statements as a whole. We used the outputs of our risk assessment, our understanding of the Society, its environment, controls, and critical business processes, to consider qualitative factors to ensure that we obtained sufficient coverage across all financial statement line items.

### Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

### Opinions on the Annual Business Statement and the Directors' Report

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

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

### Matters on which we are required to report by exception

We have nothing to report in respect of the following matters in relation to which the Building Societies Act 1986 requires us to report to you if, in our opinion:

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

### Responsibilities of Directors

As explained more fully in the directors' responsibilities statement set out on page 11, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## Independent auditor's report to the Members of Vernon Building Society for the year ended 31 December 2021 (continued)

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

### Auditor's responsibilities for the audit of the financial statements

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

The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud.

Based on our understanding of the Society and its industry, we considered that non-compliance with following laws and regulations might have a material effect on the financial statements: regulatory and supervisory requirements of the Prudential Regulatory Authority (PRA), the Financial Conduct Authority (FCA), anti-money laundering and General Data Protection Regulation (GDPR) regulation.

To help us identify instances of non-compliance with these laws and regulations, and in identifying and assessing risks of material misstatement in respect to irregularities including non-compliance with laws and regulations, our procedures included but were not limited to:

- Gaining an understanding of the legal and regulatory framework applicable to the Society, the industry in which it operates and considered the risk of acts by the Society which were contrary to the applicable laws and regulations, including fraud;
- Inquiring of the directors, management and, where appropriate, those charged with governance, as to whether the Society is in compliance with laws and regulations, and discussing their policies and procedures regarding compliance with laws and regulations;
- Inspecting correspondence with relevant licensing or regulatory authorities including Prudential Regulatory Authority (PRA).
- Reviewing minutes of director's meetings in the year; and
- Discussing amongst the engagement team the laws and regulations listed above and remaining alert to any indications of non-compliance.

We also considered those other laws and regulations that have a direct impact on the preparation of annual accounts, such as the Building Societies Act 1986 and UK tax legislation.

In addition, we evaluated the directors' and management's incentives and opportunities for fraudulent manipulation of the financial statements, including the risk of management override of controls, and determined that the principal risks related to posting manual journal entries to manipulate financial performance, management bias through judgements and assumptions in significant accounting estimates.

## Independent auditor's report to the Members of Vernon Building Society for the year ended 31 December 2021 (continued)

Our procedures in relation to fraud included but were not limited to:

- Making enquiries of the directors and management on whether they had knowledge of any actual, suspected or alleged fraud;
- Gaining an understanding of the internal controls established to mitigate risks related to fraud;
- Discussing amongst the engagement team the risks of fraud such as opportunities for fraudulent manipulation of annual accounts, and determined that the principal risks were related to posting manual journal entries to manipulate financial performance, management bias through judgements and assumptions in significant accounting estimates, in particular in relation to loan loss provisions, and significant one-off or unusual transactions; and
- Addressing the risks of fraud through management override of controls by performing journal entry testing.

The primary responsibility for the prevention and detection of irregularities, including fraud, rests with both those charged with governance and management. As with any audit, there remained a risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

As a result of our procedures, we did not identify any key audit matters relating to irregularities. The risks of material misstatement that had the greatest effect on our audit are discussed in the "Key audit matters" section of this report.

A further description of our responsibilities is available on the Financial Reporting Council's website at [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities).

### Other matters which we are required to address

Following the recommendation of the audit committee, we were appointed by the directors on 15 September 2020, to audit the financial statements for the year ended 31 December 2020 and subsequent financial periods. The period of total uninterrupted engagement is two years, covering the years ending 31 December 2020 to 31 December 2021.

The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Society and we remain independent of the Society in conducting our audit.

Our audit opinion is consistent with the additional report to the audit committee.

### Use of the audit report

This report is made solely to the Society's Members as a body in accordance with Chapter 3 of Part 16 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society'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 Society and the Society's Members as a body for our audit work, for this report, or for the opinions we have formed.



David Allen (Senior Statutory Auditor) for and on behalf of Mazars LLP

Chartered Accountants and Statutory Auditor

Mazars LLP

One St Peter's Square

Manchester

M2 3DE

24 February 2022

## Statement of Comprehensive Income for the year ended 31 December 2021

	Notes	2021 £'000	2020 £'000
Interest receivable and similar income	3	8,384	7,958
Interest payable and similar charges	4	(1,642)	(1,718)
<b>Net interest receivable</b>		<b>6,742</b>	<b>6,240</b>
Fees and commissions receivable	5	48	47
Fees payable		(28)	(34)
Net gains / (losses) from other financial instruments at fair value through profit or loss	6	251	(172)
<b>Total Income</b>		<b>7,013</b>	<b>6,081</b>
Administration expenses	7	(4,905)	(4,689)
Depreciation and amortisation	18, 19	(240)	(251)
Other operating charges		(30)	(30)
<b>Operating profit before impairment losses and provisions</b>		<b>1,838</b>	<b>1,111</b>
Loss on disposal of fixed assets	18	(2)	(2)
Release of provisions for loans and advances to credit institutions	13	-	10
Impairment provision release / (increase) on loans and advances to customers	17	172	(225)
Increase of provisions for liabilities	27	(1)	(3)
<b>Profit on ordinary activities before taxation</b>		<b>2,007</b>	<b>891</b>
Taxation on profit on ordinary activities	10	(399)	(187)
<b>Profit for the financial year</b>		<b>1,608</b>	<b>704</b>
<b>Other Comprehensive Income</b>			
Unrealised gains on available for sale financial instruments		9	10
Less: realised losses recycled through comprehensive income		-	(7)
<b>Movements in available for sale reserve</b>		<b>9</b>	<b>3</b>
Taxation on other comprehensive income		(3)	(1)
<b>Total comprehensive income for the year</b>		<b>1,614</b>	<b>706</b>

Both the profit for the financial year and total comprehensive income for the period are attributable to the Members of the Society.

The accounting policies and notes on pages 35 to 59 form part of these accounts.

## Statement of Financial Position at 31 December 2021

	Notes	2021 £'000	2020 £'000
<b>ASSETS</b>			
Cash in hand and balances with the Bank of England	11	37,749	36,227
Loans and advances to credit institutions	12	17,030	23,419
Debt securities	14	9,399	6,923
<b>Liquid Assets</b>		<b>64,178</b>	<b>66,569</b>
Derivative financial instruments	15	1,927	12
		<b>1,927</b>	<b>12</b>
Loans and advances to customers			
Loans fully secured on residential property	16	307,100	279,982
Other loans fully secured on land	16	4,087	5,798
		<b>311,187</b>	<b>285,780</b>
Intangible fixed assets	19	69	63
Tangible fixed assets	18	1,492	1,639
Deferred tax asset	21	20	21
Other assets	20	7	12
Prepayments	22	731	558
<b>Total Assets</b>		<b>379,611</b>	<b>354,654</b>
<b>LIABILITIES</b>			
Shares	23	331,061	310,133
Amounts owed to credit institutions	24	7,981	6,002
Amounts owed to other customers	25	14,112	12,271
Derivative financial instruments	15	307	1,790
Deferred tax liability	21	80	72
Other liabilities	26	566	401
Accruals		313	406
Provisions for liabilities	27	-	2
		<b>354,420</b>	<b>331,077</b>
<b>RESERVES</b>			
General reserves		25,180	23,572
Available for sale reserves		11	5
<b>Total Equity and Liabilities</b>		<b>379,611</b>	<b>354,654</b>

The accounting policies and notes on pages 35 to 59 form part of these accounts.

The accounts were approved by the Board of Directors on 24 February 2022 and were signed on its behalf by:

*Susan Jee*  
Susan Jee (Feb 24, 2022 12:31 GMT)

*J R Hughes*  
J R Hughes (Feb 24, 2022 11:34 GMT)

*steve fletcher*  
steve fletcher (Feb 24, 2022 11:21 GMT)

S Jee Chair  
J Hughes Vice-Chair  
S Fletcher Director & Chief Executive

## Statement of Changes in Members' Interests at 31 December 2021

	General Reserve £000	Available for sale reserve £000	Total Equity attributable to Members £000
<b>At 1 January 2020</b>	<b>22,868</b>	<b>3</b>	<b>22,871</b>
Comprehensive income for the year	704	-	704
Other comprehensive income for the year	-	2	2
Total comprehensive income for the year	704	2	706
<b>At 31 December 2020</b>	<b>23,572</b>	<b>5</b>	<b>23,577</b>
Comprehensive income for the year	1,608	-	1,608
Other comprehensive income for the year	-	6	6
Total comprehensive income for the year	1,608	6	1,614
<b>At 31 December 2021</b>	<b>25,180</b>	<b>11</b>	<b>25,191</b>

The accounting policies and notes on pages 35 to 59 form part of these accounts.

## Cash Flow Statement for the year ended 31 December 2021

	2021 £'000	2020 £'000
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Operating profit	2,007	891
<b>Adjustments for:</b>		
Depreciation and amortisation of fixed assets	240	251
Gain on disposal of debt securities	-	(7)
Loss on disposal of fixed assets	2	2
Impairment (gains) / losses on loans and advances to customers	(172)	225
Release of provisions for loans and advances to credit institutions	-	(10)
	<b>2,077</b>	<b>1,352</b>
<b>Changes in operating assets and liabilities:</b>		
Changes in fair values of financial instruments within hedge accounting	(284)	156
Increase in accrued interest of debt securities	18	4
Increase in prepayments and accrued income	(173)	(79)
(Increase) / decrease in accruals and deferred income	(92)	230
Decrease / (increase) in other assets	5	(4)
(Decrease) / increase in other liabilities	(32)	102
Decrease in provisions for liabilities	(2)	(6)
Increase in loans and advances to customers	(28,491)	(36,602)
Increase in shares	21,069	34,230
Taxation paid	(197)	(57)
<b>Net cash outflow from operating activities</b>	<b>(6,102)</b>	<b>(674)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Movement in:		
Amounts owed to credit institutions and other customers	3,820	8,675
<b>Net cash inflow from financing activities</b>	<b>3,820</b>	<b>8,675</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds on sale/maturity of debt securities	-	9,520
Purchase of debt securities	(2,484)	(11,014)
Purchase of fixed assets	(101)	(86)
Movement in loans and advances to credit institutions	(944)	(1,658)
<b>Net cash outflow from investing activities</b>	<b>(3,529)</b>	<b>(3,238)</b>
<b>Net (decrease) / increase in cash and cash equivalents</b>	<b>(5,811)</b>	<b>4,763</b>
Cash and cash equivalents at beginning of year	50,583	45,820
<b>Cash and cash equivalents at end of year</b>	<b>44,772</b>	<b>50,583</b>

The accounting policies and notes on pages 35 to 59 form part of these accounts.

## Notes to the accounts for the year ended 31 December 2021

### 1. PRINCIPAL ACCOUNTING POLICIES

The accounts have been prepared in accordance with the Building Societies Act 1986, the Building Societies (Accounts and Related Provisions) Regulations 1998 and Financial Reporting Standard 102 ("FRS 102"), The Financial Reporting Standard applicable in the UK and Republic of Ireland. The Society has also chosen to apply the recognition and measurement provisions of IAS 39 Financial Instruments: Recognition and Measurement (as adopted for use in the UK). The presentation currency of these annual accounts is sterling. All amounts in the annual accounts have been rounded to the nearest £1,000.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these annual accounts.

The address of the Society's registered office is 19 St Petersgate, Stockport, Cheshire, SK1 1HF.

#### 1.1 Measurement convention

The annual accounts are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments and financial instruments classified at fair value through profit and loss or classified as available for sale.

#### 1.2 Interest

Interest income and expense are recognised in the statement of comprehensive income using the effective interest method. The 'effective interest rate' is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or financial liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Society estimates future cash flows considering all contractual terms of the financial instrument, but not credit losses. The calculation of the effective interest rate includes transaction costs and fees paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or financial liability. Fees and commissions included in the effective interest rate are spread on a straight-line basis over the expected life of the financial instrument, which is materially consistent with FRS 102.

Interest income and expense presented in the statement of comprehensive income and other comprehensive income (OCI) include

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest on available-for-sale investment securities calculated on an effective interest basis; and
- the effective portion of fair value changes in qualifying hedging derivatives designated in fair value hedges of interest rate risk.

Fair value changes on derivatives held for risk management purposes, and other financial assets and financial liabilities carried at fair value through the statement of comprehensive income, are presented in *net gains/(losses) from other financial instruments at fair value through profit or loss*.

#### 1.3 Fees and commission

Fees and commission income and expenses that are directly attributable to the acquisition or issue of the financial asset or financial liability are included in the measurement of the effective interest rate (see 1.2). Other fees and commission income and expense are recognised at the point products are sold or services are rendered.

#### 1.4 Operating leases

Payments made under operating leases are recognised in the statement of comprehensive income on a straight-line basis over the term of the lease unless the payments to the lessor are structured to increase in line with expected general inflation; in which case the payments related to the structured increases are recognised as incurred.

#### 1.5 Other operating charges

Other operating charges include finance charges payable to the Society's clearing banks. Finance charges are recognised at the point the services are received.

#### 1.6 Taxation

Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in equity or other comprehensive income, in which case it is recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income for the year, using tax rates enacted or substantively enacted at the statement of financial position date, and any adjustment to tax payable in respect of previous years. Deferred tax is provided on timing differences which arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in the annual accounts.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

#### 1.6 Taxation (continued)

Deferred tax is not recognised on permanent differences arising because certain types of income or expense are non-taxable or are disallowable for tax or because certain tax charges or allowances are greater or smaller than the corresponding income or expense.

Deferred tax is measured at the tax rate that is expected to apply to the reversal of the related difference, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax balances are not discounted. Unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

#### 1.7 Financial instruments

##### Recognition

The Society initially recognises loans and advances and deposits on the date on which they are originated. All other financial instruments are recognised on the trade date, which is the date on which the Society becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability that is measured at amortised cost is measured initially at fair value plus transaction costs that are directly attributable to its acquisition or issue.

##### Classification

###### Financial assets

The Society classifies its financial assets into one of the following categories:

- **Loans and receivables**

'Loans and advances' are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Society does not intend to sell immediately or in the near term. Loans and advances are initially measured at fair value plus incremental direct transaction costs and subsequently measured under the effective interest method (see 1.2).

- **Available-for-sale**

Available-for-sale investments are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments comprise debt securities and are measured at fair value after initial recognition.

Interest income is recognised in the statement of comprehensive income using the effective interest method (see 1.2). Impairment losses are recognised in the statement of comprehensive income.

Other fair value changes, other than impairment losses, are recognised in OCI and presented in the available for sale reserve within equity. When the investment is sold, the gain or loss accumulated in equity is recycled through profit or loss in the statement of comprehensive income.

- **At fair value through profit and loss**

Derivative financial instruments are recognised at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged. On initial designation of the hedge, the Society formally documents the relationship between the hedging instruments and hedged items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Society makes an assessment, both at inception of the hedge relationship and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value of the respective hedged items during the period for which the hedge is designated, and assesses actual results periodically to confirm that the each hedge is highly effective.

Where a derivative financial instrument is designated as a hedge of the variability in fair value of a recognised asset or liability or an unrecognised firm commitment, all changes in the fair value of the derivative are recognised immediately in the statement of comprehensive income. The carrying value of the hedged item is adjusted by the change in fair value that is attributable to the risk being hedged (even if it is normally carried at cost or amortised cost) and any gains or losses on remeasurement are recognised immediately in profit or loss (even if those gains would normally be recognised directly in reserves). If hedge accounting is discontinued and the hedged financial asset or liability has not been derecognised, any adjustments to the carrying amount of the hedged item are amortised into the statement of comprehensive income using the effective interest method over the remaining life of the hedged item.

###### Financial liabilities

The Society classifies its financial liabilities, other than financial guarantees and loan commitments, as measured at amortised cost or fair value through profit and loss.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

#### 1.7 Financial instruments (continued)

##### Derecognition

The Society derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Society neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of; (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Society is recognised as a separate asset or liability.

The Society derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

##### Measurement

###### Amortised cost measurement

The amortised cost of a financial asset or financial liability is the net of the i) amount at which the financial asset or financial liability is measured at initial recognition; ii) minus any repayments of the principal; iii) plus or minus the cumulative amortisation using the effective interest method of any difference between the amount at initial recognition and the maturity amount; iv) minus, in the case of a financial asset, any reduction for impairment or uncollectability.

###### Fair value measurement

'Fair value' is the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

When available, the Society measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Society uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

As a direct result of the Interest Rate Benchmark Reform, the swap derivatives held by the Society for hedging purposes referencing Libor market rate will transition to referencing the Sonia risk free rate instead, plus a margin as agreed by the International Swaps and Derivatives Association (ISDA). The Society has elected to transition its swap derivatives using the 'ISDA fallback protocol', a process established to manage the implications of a reference rate no longer being available, such as with the withdrawal of Libor. The transition will take place within Q1 2022 when each of the Libor swap contracts next reprices between 31st January to 31 March, onto the Sonia risk free rate plus the agreed margin.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Society determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in the statement of comprehensive income on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

###### Identification and measurement of impairment

At each reporting date, the Society assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a Society of financial assets is 'impaired' when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired includes:

- Significant financial difficulty of the borrower or issuer;
- Default or delinquency by a borrower;
- The restructuring of a loan or advance by the Society on terms that the Society would not consider otherwise;
- Indications that a borrower or issuer will enter bankruptcy or into an individual voluntary arrangement;
- The disappearance of an active market for a security; or
- Observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

The Society considers evidence of impairment for loans and advances at both a specific asset and a collective level. All individually significant loans and advances are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances that are not individually significant are collectively assessed for impairment by grouping together loans and advances with similar risk characteristics.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

#### 1.7 Financial instruments (continued)

##### Measurement; identification and measurement of impairment (continued)

In assessing collective impairment, the Society uses historical trends of the probability of default, the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than is suggested by historical trends. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

A range of forbearance options are available to support customers who are in financial difficulty. The purpose of forbearance is to support customers who have temporary financial difficulties and help them get back on track.

Customers requesting a forbearance option will need to provide information to support the request which is likely to include a budget planner, statement of assets and liabilities, bank/credit card statements, payslips etc. in order that the request can be properly assessed. If the forbearance request is granted the account is monitored in accordance with our policy and procedures. At the appropriate time the forbearance option that has been implemented is cancelled, with the exception of capitalisation of arrears, and the customer's normal contractual payment is restored.

Impairment losses are recognised in profit and loss and reflected in an allowance account against loans and receivables. Interest on the impaired assets continues to be recognised through the unwinding of the discount. If an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit and loss. Impairment losses on available-for-sale investment securities are recognised by reclassifying the losses accumulated in the fair value reserve in equity to profit and loss. The cumulative loss that is reclassified from equity to profit and loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit and loss. Changes in impairment attributable to application of the effective interest method are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed through other comprehensive income; otherwise, any increase in fair value is recognised through OCI. Any subsequent recovery in the fair value of an impaired available-for-sale equity security is always recognised in OCI.

The Society has a closed portfolio of equity release mortgage loans, representing 1.6% of total Loans and advances to customers (2020: 2.0%). A particular clause of the mortgage contract meets the definition of an insurance contract, which is accounted for under FRS103, where a borrower dies or goes into long term care and a redemption receipt is less than the contractual sum owed the Society does not have any further ability to recover amounts from the borrower or the estate.

Under FRS102 the Society has continued to account for these mortgage contracts using its existing accounting policies. The mortgage contract has been classified as being not unbundled. The impact of assessing the contracts as being "not unbundled" is that the income earned on the mortgage contracts is not split between interest and insurance premium and that the mortgage asset is included within loans and advances at the present value of future cash flows.

Measurement and recognition of the income earned on the mortgage contract has been undertaken in line with the Society's other mortgage contracts; the income earned has been included in the Statement of comprehensive income within the 'Interest receivable and similar income' category. Within the Statement of financial position the mortgage asset (page 32), along with any impairment if there were any, is disclosed materially in line with IAS 39.

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

#### 1.8 Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash comprises cash in hand, balances with the Bank of England and unrestricted loans and advances to credit institutions repayable on demand. Cash equivalents comprise highly liquid unrestricted investments that are readily convertible into cash with an insignificant risk of changes in value with original maturities of less than three months. The Statements of Cash Flows have been prepared using the indirect method.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 1. PRINCIPAL ACCOUNTING POLICIES (CONTINUED)

#### 1.9 Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation. Where parts of an item of tangible fixed assets have different useful lives, they are accounted for as separate items of tangible fixed assets, for example land is treated separately from buildings. The Society assesses at each reporting date whether any tangible fixed assets are impaired.

Depreciation is charged to the statement of comprehensive income on a straight-line basis over the estimated useful lives of each part of an item of tangible fixed assets. Leased assets are depreciated over the shorter of the lease term and their useful lives. Land is not depreciated. The estimated useful lives are as follows:

- Freehold buildings: 10 to 50 years
- Fixtures, fittings, plant, equipment and vehicles: 4 to 10 years

Depreciation methods, useful lives and residual values are reviewed if there is an indication of a significant change since the last annual reporting date in the pattern by which the Society expects to consume an asset's future economic benefits. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

#### 1.10 Intangible assets

##### Computer software

The costs of computer software acquired where the Society will derive future economic benefit are capitalised at the acquisition date.

##### Amortisation

Amortisation is charged to the statement of comprehensive income on a straight-line basis over the estimated useful lives. Computer software is amortised from the date it is available for use. The estimated useful lives is four years based on historical experience.

The Society reviews the amortisation period and method when events and circumstances indicate that the useful life may have changed since the last reporting date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

#### 1.11 Provision and contingent liabilities

The Society recognises a provision when there is a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and the amount has been reliably estimated. Note 27 provides details of the provisions recognised by the Society at the year end.

Contingent liabilities are potential obligations from past events which will only be confirmed by future events. Contingent liabilities are not recognised in the Statement of financial position.

#### 1.12 Impairment excluding financial assets and deferred tax assets

The carrying amounts of the entity's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss is recognised if the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognised through profit and loss in the statement of comprehensive income. An impairment loss is reversed if and only if the reasons for the impairment have ceased to apply.

#### 1.13 Employee benefits

The Society operates a defined contributions personal pension plan, the assets of which are held separately from those of the Society. The Society recognises a cost equal to its contribution payable for the period. The Society also provides death in service cover and a health cash-plan and recognises a cost equal to the premium payable for the period. In addition, the Society also provides volunteering days within the community.

### 2. ACCOUNTING ESTIMATES AND JUDGEMENTS

As part of the preparation the Annual report and Accounts the Society makes estimates and judgements that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and are based on many factors including historical experience and expectations of future events that are believed to be reasonable under the circumstances. These estimates and judgements are described below:

#### a) Impairment losses on loans and advances to customers

The Society reviews its loans and advances to customers on a regular basis to assess impairment. In determining whether an impairment loss should be recorded, the Society is required to exercise a degree of judgement. Impairment provisions are calculated using historical arrears experience, modelled credit risk characteristics and information from external data agencies.

Estimates are applied to determine prevailing market conditions (e.g. interest rates and house prices), customer behaviour (e.g. default rates) and the length of time expected to complete the sale of properties in possession. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to minimise any difference between loss estimates and actual loss experience. The carrying amount of the provision held against impairment losses on loans and advances to customers at the year end is £0.4m (2020: £0.5m); the impact of a 5% increase in the forced sale discount would impact provisions in 2021 by circa £0.3m (2020: £0.3m) and the impact of a 5% decrease in forced sale discount would be circa £0.3m (2020: £0.2m).

#### b) Effective Interest Rate (EIR)

In determining the expected life of mortgage assets, the Society uses historical and forecast redemption data as well as management judgement. Throughout the year, the expected life of mortgage assets is reassessed for reasonableness. A variation in the expected life of mortgage assets may result in an adjustment to the carrying value in the statement of financial position and to the timing of the recognition of interest income. At the year end the total adjustment to loans and advances applying the EIR method was £0.1m (2020: £0.1m); a change in the life of the loan by an additional month would change the net carrying value of mortgage assets by circa £0.2m (2020: £0.2m).

#### c) Fair value of derivatives and financial assets

The Society employs the following techniques in determining the fair value of its derivatives and financial assets:

Derivative financial instruments – calculated by discounted cash flow models using yield curves that are based on observable market data. These assets are held by the Society in its management of interest rate risk. At the year end the fair value of the derivatives held by the Society was £1.6m (2020: £1.8m); a change in the yield curve of 0.5% would change the net fair value of derivative financial instruments by circa £1.4m (2020: £1.2m). The fair value impact to the derivatives would be largely offset by the hedge risk fair value adjustment applied to the hedged instruments through hedge accounting, reducing the net impact to £0.1m (2020: £0.0m).

## Notes to the accounts for the year ended 31 December 2021 (continued)

	2021 £'000	2020 £'000
<b>3. INTEREST RECEIVABLE AND SIMILAR INCOME</b>		
On loans fully secured on residential property	8,764	8,055
On other loans fully secured on land	205	284
On debt securities:		
Interest and amortisation of premiums	21	24
Gain on disposal	-	7
On other liquid assets		
Interest	72	135
Net interest expense on derivatives	(678)	(547)
<b>Total interest receivable and similar income</b>	<b>8,384</b>	<b>7,958</b>
No geographical analysis is presented because all of the Society's activities are conducted within the UK.		
<b>4. INTEREST PAYABLE AND SIMILAR CHARGES</b>		
On shares held by individuals	1,563	1,663
On other shares	21	38
On deposits and other borrowings	34	21
Net interest expenses / (income) on derivatives	24	(4)
<b>Total interest payable and similar charges</b>	<b>1,642</b>	<b>1,718</b>
<b>5. FEES AND COMMISSION RECEIVABLE</b>		
Loans and advances related	10	8
Insurance commissions	38	40
Other	-	(1)
<b>Total fees and commission receivable</b>	<b>48</b>	<b>47</b>
<b>6. NET GAINS / (LOSSES) FROM OTHER FINANCIAL INSTRUMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS</b>		
Derivatives in designated fair value hedge relationships	3,323	(1,058)
Adjustments to hedged items in fair value hedge accounting relationships	(3,122)	1,044
Derivatives not in designated fair value hedge accounting relationships	40	(77)
Realised gain / (losses) on interest rate hedge terminations	10	(81)
<b>Total net gains / (losses) from other financial instruments at fair value through profit or loss</b>	<b>251</b>	<b>(172)</b>
<b>7. ADMINISTRATION EXPENSES</b>		
Staff costs (note 8)	3,246	3,146
Other administrative expenses	1,659	1,543
<b>Total administration expenses</b>	<b>4,905</b>	<b>4,689</b>
Other administrative expenses include:		
Remuneration of auditors (excluding VAT)		
Statutory audit fees	89	85
Operating lease costs in respect of land and buildings (note 28)	41	41

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 8. STAFF NUMBERS AND COSTS

The average number of persons employed (including executive directors) during the year was as follows:

	2021		2020	
	Full time No.	Part time No.	Full time No.	Part time No.
Head office	45	12	40	13
Branch offices	13	14	15	12
	<b>58</b>	<b>26</b>	<b>55</b>	<b>25</b>

The aggregate costs of these persons were as follows:

	2021 £'000	2020 £'000
Wages and salaries	2,716	2,637
Social security costs	267	262
Other pension costs	263	247
	<b>3,246</b>	<b>3,146</b>

### 9. DIRECTORS' EMOLUMENTS

- (a) Directors' Emoluments total £512,000 (2020: £506,000). Full details of all directors' remuneration are contained in the Directors' Remuneration Report on page 22.
- (b) There are no directors who have loans described in section 65 of the Building Societies Act 1986. In accordance with section 68 of the Building Societies Act, the Society maintains a register which shows details of all loans, transactions and arrangements with directors. A statement of the appropriate details contained in the register for the current financial year will be available for inspection at the head office for a period of 15 days up to and including the Society's Annual General Meeting.

### 10. TAXATION ON PROFIT ON ORDINARY ACTIVITIES

	2021 £'000	2020 £'000
<b>Current tax:</b>		
Current tax on income for the period	396	199
Adjustments in respect of prior periods	(3)	-
Total current tax	<b>393</b>	<b>199</b>
<b>Deferred tax (see note 21):</b>		
Origination and reversal of timing differences	(13)	(18)
Adjustments in respect of prior periods	3	-
Change in tax rate	16	6
Total deferred tax	<b>6</b>	<b>(12)</b>
<b>Total Tax</b>	<b>399</b>	<b>187</b>

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 10. TAXATION ON PROFIT ON ORDINARY ACTIVITIES (CONTINUED)

	2021 £'000			Current tax	2020 £'000 Deferred tax	Total tax
	Current tax	Deferred tax	Total tax			
Recognised in profit and loss account	393	6	399	199	(12)	187
Recognised in other comprehensive income	-	3	3	1	-	1
<b>Total tax</b>	<b>393</b>	<b>9</b>	<b>402</b>	<b>200</b>	<b>(12)</b>	<b>188</b>

#### Reconciliation of effective tax rate:

	2021 £'000	2020 £'000
Profit for the year	1,608	704
Total tax expense	399	187
<b>Profit excluding taxation</b>	<b>2,007</b>	<b>891</b>
Tax using the UK corporation tax rate of 19% (2020: 19%)	381	169
Non-deductible expenses	2	12
Change in tax rate on deferred tax balances	16	6
<b>Total tax expense included in profit and loss</b>	<b>399</b>	<b>187</b>

The effective rate of tax applied to operating profit on ordinary activities is 19.88% (2020 - 20.99%)

The corporation tax rate for the year ended 31 December 2021 was 19%, enacted with effect from 1 April 2017. On the 3 March 2021 the UK Government announced that the rate of tax would increase to 25% from April 2023, this was substantively enacted 24 May 2021.

### 11. CASH AND CASH EQUIVALENTS

	2021 £'000	2020 £'000
Cash in hand and balances with the Bank of England	37,749	36,227
Loans and advances to credit institutions (see note 12)	7,023	14,356
<b>Cash and cash equivalents per cash flow statement</b>	<b>44,772</b>	<b>50,583</b>

### 12. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

Loans and advances to credit institutions are repayable from the balance sheet date as follows:

	2021 £'000	2020 £'000
On demand	7,023	14,356
In not more than three months	3,503	5,797
In more than three months but less than one year	6,504	1,690
In more than one year but less than five years	-	1,522
In more than five years	-	54
<b>Total loans and advances to credit institutions</b>	<b>17,030</b>	<b>23,419</b>

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 13. PROVISIONS FOR LOANS AND ADVANCES TO CREDIT INSTITUTIONS

Heritable Bank plc was placed into administration by UK authorities on 7 October 2009 at which time the Society had a deposit of £1,000,000. As at 31 December 2019 the Society had received dividends totalling £989,000 and so had provided an amount of £11,000 on the basis of publicly available information and information contained within Administrators' Reports to the Creditors. During 2020 a final dividend of £10,000 was received, resulting in a provision release of £10,000.

### 14. DEBT SECURITIES

#### a) Floating rate notes

	2021 £'000	2020 £'000
	9,399	6,923
	<b>9,399</b>	<b>6,923</b>
Debt securities have the following maturities:		
In not more than one year	2,002	-
In more than one year	7,397	6,923
	<b>9,399</b>	<b>6,923</b>
Transferable debt securities comprise:		
Listed on a recognised exchange	9,399	6,923
	<b>9,399</b>	<b>6,923</b>

The directors consider the securities held as liquid assets are held with the intention of use on a continuing basis in the Society's activities and are therefore classified as 'financial fixed assets' rather than current assets. Movements during the year of transferable securities held as 'financial fixed assets' are analysed as follows:

#### b) Movements in debt securities during the year summarised as follows:

	2021 £'000	2020 £'000
At 1 January	6,923	5,423
Additions	2,484	11,014
Disposals and maturities	-	(9,569)
Accrued interest movement	(18)	52
Net gains from changes in fair value recognised in other comprehensive income	10	3
<b>At 31 December</b>	<b>9,399</b>	<b>6,923</b>

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 15. DERIVATIVE FINANCIAL INSTRUMENTS

	Positive market value 2021 £'000	Negative market value 2021 £'000
Derivatives designated as fair value hedges:		
Interest rate swaps	1,905	(250)
Derivatives not in hedge relationships:		
Interest rate swaps	22	(57)
	<b>1,927</b>	<b>(307)</b>

The fair value movement of the interest rate swaps is caused by changes in the interest rate outlook over the next five years. The outlook for the prior year had reduced due to the uncertainty that came with the Covid-19 pandemic before increasing back during the current financial year following improved economic outlooks.

	Positive market value 2020 £'000	Negative market value 2020 £'000
Derivatives designated as fair value hedges:		
Interest rate swaps	2	(1,708)
Derivatives not in hedge relationships:		
Interest rate swaps	10	(82)
	<b>12</b>	<b>(1,790)</b>

### 16. LOANS AND ADVANCES TO CUSTOMERS

	2021 £'000	2020 £'000
Loans fully secured on residential property	308,763	278,399
Fair value adjustment for hedge risk	(1,663)	1,583
	<b>307,100</b>	<b>279,982</b>
Loans fully secured on land	4,087	5,788
Fair value adjustment for hedge risk	-	10
	<b>4,087</b>	<b>5,798</b>
	<b>311,187</b>	<b>285,780</b>
The remaining maturity of loans and advances to customers from the reporting date is as follows:		
On call or short notice	1,953	1,015
In not more than three months	1,326	1,730
In more than three months but not more than one year	8,376	7,637
In more than one year but not more than five years	52,603	53,858
In more than five years	248,949	220,476
Fair value adjustment for hedge risk on loans fully secured on residential property or land	(1,663)	1,593
	<b>311,544</b>	<b>286,309</b>
Less: Impairment of Loans and advances to customers (Note 17)	(357)	(529)
	<b>311,187</b>	<b>285,780</b>

Note: the maturity analysis is based upon contractual maturity not expected redemption levels.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 17. IMPAIRMENT LOSSES ON LOANS AND ADVANCE TO CUSTOMERS

	2021		
	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000	TOTAL £'000
<b>At 1st January 2021</b>			
Collective impairment	463	2	465
Individual impairment	64	-	64
	<b>527</b>	<b>2</b>	<b>529</b>
<b>Income and expenditure account</b>			
Release for the year			
Collective impairment	(166)	-	(166)
Individual impairment	(6)	-	(6)
	<b>(172)</b>	<b>-</b>	<b>(172)</b>
<b>Amount written off during the year</b>			
Collective impairment	-	-	-
Individual impairment	-	-	-
	<b>-</b>	<b>-</b>	<b>-</b>
<b>At 31st December 2021</b>			
Collective impairment	297	2	299
Individual impairment	58	-	58
	<b>355</b>	<b>2</b>	<b>357</b>

There were no loans written off during the year or net credits in respect of additional costs and recoveries against loans which had been written off in prior years.

	2020		
	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000	TOTAL £'000
<b>At 1st January 2020</b>			
Collective impairment	222	4	226
Individual impairment	78	-	78
	<b>300</b>	<b>4</b>	<b>304</b>
<b>Income and expenditure account</b>			
Charge/(Release) for the year			
Collective impairment	241	(2)	239
Individual impairment	(14)	-	(14)
	<b>227</b>	<b>(2)</b>	<b>225</b>
<b>Amount written off during the year</b>			
Collective impairment	-	-	-
Individual impairment	-	-	-
	<b>-</b>	<b>-</b>	<b>-</b>
<b>At 31st December 2020</b>			
Collective impairment	463	2	465
Individual impairment	64	-	64
	<b>527</b>	<b>2</b>	<b>529</b>

Please refer to note 30 (pages 53-56) for more information on the credit risk associated with the Loans and advances to customers, the Society's approach to mitigating against this risk and analysis of the portfolio.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 18. TANGIBLE FIXED ASSETS

	LAND & BUILDINGS FREEHOLD £'000	PLANT & MACHINERY £'000	EQUIPMENT, FIXTURES, FITTINGS & VEHICLES £'000	TOTAL £'000
<b>Cost</b>				
At 1 January 2021	1,764	356	1,377	3,497
Additions	-	25	32	57
Disposals	-	-	(3)	(3)
<b>At 31 December 2021</b>	<b>1,764</b>	<b>381</b>	<b>1,406</b>	<b>3,551</b>
<b>Accumulated depreciation</b>				
At 1 January 2021	476	334	1,048	1,858
Charged in year	58	3	141	202
Disposals	-	-	(1)	(1)
<b>At 31 December 2021</b>	<b>534</b>	<b>337</b>	<b>1,188</b>	<b>2,059</b>
<b>Net book value</b>				
<b>At 31 December 2021</b>	<b>1,230</b>	<b>44</b>	<b>218</b>	<b>1,492</b>
At 31 December 2020	1,288	22	329	1,639

The net book value of land and buildings occupied by the Group and Society for its own activities as at 31 December 2021 was £1,230,000 (2020: £1,288,000).

### 19. INTANGIBLE FIXED ASSETS

	SOFTWARE £'000
<b>Cost:</b>	
At 1 January 2021	408
Additions	44
Disposals	-
<b>At 31 December 2021</b>	<b>452</b>
<b>Accumulated amortisation</b>	
At 1 January 2021	345
Charged in year	38
Disposals	-
<b>At 31 December 2021</b>	<b>383</b>
<b>Net book value</b>	
<b>At 31 December 2021</b>	<b>69</b>
At 31 December 2020	63

## Notes to the accounts for the year ended 31 December 2021 (continued)

20. OTHER ASSETS	2021 £'000	2020 £'000
Other assets due within one year comprise:		
Amounts receivable from non-cancellable operating lease	7	12
	<b>7</b>	<b>12</b>

Other assets include an amount of £nil not repayable for more than one year (2020: £nil)

21. DEFERRED TAX	2021 £'000	2020 £'000
At 1 January	(51)	(63)
(Charge) / Credit to profit and loss account	(6)	12
(Charge) / Credit to other comprehensive income	(3)	-
<b>At 31 December</b>	<b>(60)</b>	<b>(51)</b>

Deferred tax assets and liabilities are attributable to the following items:

### Deferred tax assets

Timing differences arising on transition to new GAAP relating to the impairment provision against loans and advances to customers

18                      18

Timing differences arising on transition to new GAAP relating to the application of hedge accounting

2                              3

**20                              21**

### Deferred tax liabilities

Other timing differences

(73)                      (64)

Timing differences arising on transition to new GAAP relating to the application of the effective interest rate (EIR) method of amortisation

(7)                              (8)

**(80)                              (72)**

**At 31 December**

**(60)                              (51)**

Deferred tax assets and liabilities are offset only where the Society has a legally enforceable right to set off current tax assets against current tax liabilities and where the assets and liabilities relate to income taxes levied by the same taxation authority on the same taxable entity, or another entity within the Society. During 2015, the Society transitioned to FRS102 from former UK GAAP which crystallised timing differences relating to taxation in the form of deferred tax adjustments. These adjustments are amortised over 10 years. From 1 April 2023 the corporation tax rate will increase from 19% to 25%. The deferred tax adjustments in relation to the GAAP transition has been revalued in relation to this tax change, and have increased by less than £1,000.

22. PREPAYMENTS AND ACCRUED INCOME	2021 £'000	2020 £'000
Prepayments	731	558
	<b>731</b>	<b>558</b>

## Notes to the accounts for the year ended 31 December 2021 (continued)

<b>23. SHARES</b>	2021 £'000	2020 £'000
Shares comprise:		
Held by individuals	325,808	304,586
Other shares	5,390	5,543
Fair value adjustment for hedged risk	(137)	4
	<b>331,061</b>	<b>310,133</b>
Shares are repayable with the remaining maturities from the balance sheet date as follows:		
On call or short notice	246,700	238,127
In not more than three months	53,965	29,233
In more than three months but not more than one year	21,977	16,588
In more than one year but not more than five years	8,556	26,181
Fair value adjustment for hedged risk	(137)	4
	<b>331,061</b>	<b>310,133</b>
<b>24. AMOUNTS OWED TO CREDIT INSTITUTIONS</b>	2021 £'000	2020 £'000
With agreed maturity dates or periods of notice:		
In not more than three months	2,007	1,000
In more than three months but not more than one year	5,002	5,002
In more than one year but not more than five years	972	-
	<b>7,981</b>	<b>6,002</b>
<b>25. AMOUNTS OWED TO OTHER CUSTOMERS</b>	2021 £'000	2020 £'000
With agreed maturity dates or periods of notice:		
Repayable on demand	7,994	9,269
In not more than three months	2,067	3,002
In more than three months but not more than one year	4,051	-
	<b>14,112</b>	<b>12,271</b>
<b>26. OTHER LIABILITIES</b>	2021 £'000	2020 £'000
Other liabilities are all due within one year and comprise:		
Corporation tax	397	200
Other creditors	169	201
	<b>566</b>	<b>401</b>

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 27. PROVISIONS

	2021 £'000	2020 £'000
	FINANCIAL OMBUDSMAN £'000	FINANCIAL OMBUDSMAN £'000
Balance at 1 January	2	8
Provisions made during the year	1	3
Provisions utilised during the year	(3)	(9)
<b>Balance at 31 December</b>	<b>-</b>	<b>2</b>

#### Financial Ombudsman

The Society may on occasion receive a number of complaints which are referred to the Financial Ombudsman Service (FOS) where the outcome may result in a compensation payment. No provisions have been recognised at the year end (2020: £2,000).

### 28. OPERATING LEASES

Non-cancellable operating lease rentals are payable as follows:

	2021 £'000	2020 £'000
Less than one year	41	52
Between one and five years	40	81
	<b>81</b>	<b>133</b>

During the year £41,000 was recognised as an expense in the profit and loss account in respect of operating leases (2020: £41,000)

### 29. PENSIONS

The Society makes contributions to a defined contribution Society personal pension plan for all qualifying staff.

The charge for the year was £263,000 (2020: £247,000)

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 30. FINANCIAL INSTRUMENTS

A financial instrument is a contract that gives rise to a financial asset or a financial liability. The Society is a retailer of financial instruments, mainly in the form of mortgage and savings products, however the Society also uses other financial instruments to invest liquid asset balances and raise wholesale funding. The Society also uses derivative financial instruments ('derivatives') to manage the risks arising from its operations.

The financial risks arising from the Society's activities include liquidity, interest rate and credit risk. The Society is also exposed to capital risk, and the policies and processes for managing this is outlined in the Director's report on pages 5-10. The Board reviews and agrees policies for managing each of these risks, which include the establishment of the Society's risk appetite, risk limits, clear reporting lines and other controls. In addition, the Society's Asset and Liabilities Committee (ALCO) monitors the financial risks relating to the financial instruments held as well as funding and liquidity, in line with the Society's prudent policy statements. The ALCO also ensures that the management of retail credit risk is consistent with the credit risk appetite.

The Society does not hold derivatives for trading or speculative purposes but uses them for hedging purposes only in accordance with the Building Society Act 1986, specifically to limit the interest rate exposure that arises with the provision of fixed rate mortgage and savings products. The Society employs interest rate swap contracts to manage the interest rate risks as summarised below:

Activity	Risk	Fair value interest rate hedge
Fixed rate mortgage	Increase in interest rates	Society pays fixed, receives variable
Fixed rate savings	Decrease in interest rates	Society receives fixed, pays variable

An interest rate swap is a contract to exchange one set of interest rate cash flows for another. The interest rate swaps result in the economic exchange of interest rates. No exchange of principal takes place, instead interest payments are based on notional principal amounts agreed at inception of the swap. The duration of the interest rate swap is generally short to medium term and their maturity profile reflects the nature of the exposures arising from the underlying business activities. The fair value of these hedges are shown in note 15.

#### CATEGORIES OF FINANCIAL ASSET AND LIABILITIES

Financial assets and liabilities are measured on an on-going basis either at fair value or at amortised cost. Note 1.6 'Financial instruments' describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The tables below analyse the Society's assets and liabilities by financial classification:

CARRYING VALUES BY CATEGORY	HELD AT AMORTISED COST		HELD AT FAIR VALUE			TOTAL £'000
	LOANS AND RECEIVABLES £'000	FINANCIAL LIABILITIES AT AMORTISED COST £'000	AVAILABLE FOR SALE £'000	DERIVATIVES DESIGNATED AS FAIR VALUE HEDGES £'000	NON- DESIGNATED DERIVATIVES £'000	
<b>31 December 2021</b>						
<b>Financial assets</b>						
Cash in hand	266	-	-	-	-	266
Balances with the Bank of England	37,483	-	-	-	-	37,483
Loans and advances to credit institutions	17,030	-	-	-	-	17,030
Debt securities	-	-	9,399	-	-	9,399
Derivative financial instruments	-	-	-	1,905	22	1,927
Loan and advances to customers	311,187	-	-	-	-	311,187
<b>Total financial assets</b>	<b>365,966</b>	<b>-</b>	<b>9,399</b>	<b>1,905</b>	<b>22</b>	<b>377,292</b>
Non financial assets	2,319	-	-	-	-	2,319
<b>Total assets</b>	<b>368,285</b>	<b>-</b>	<b>9,399</b>	<b>1,905</b>	<b>22</b>	<b>379,611</b>
<b>Financial liabilities</b>						
Shares	-	331,061	-	-	-	331,061
Amounts owed to credit institutions	-	7,981	-	-	-	7,981
Amounts owed to other customers	-	14,112	-	-	-	14,112
Derivative financial instruments	-	-	-	250	57	307
<b>Total financial liabilities</b>	<b>-</b>	<b>353,154</b>	<b>-</b>	<b>250</b>	<b>57</b>	<b>353,461</b>
Non financial liabilities	-	959	-	-	-	959
<b>Total liabilities</b>	<b>-</b>	<b>354,113</b>	<b>-</b>	<b>250</b>	<b>57</b>	<b>354,420</b>

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 30. FINANCIAL INSTRUMENTS (CONTINUED)

#### CATEGORIES OF FINANCIAL ASSET AND LIABILITIES (CONTINUED)

CARRYING VALUES BY CATEGORY	HELD AT AMORTISED COST		HELD AT FAIR VALUE			TOTAL £'000
	LOANS AND RECEIVABLES £'000	FINANCIAL LIABILITIES AT AMORTISED COST £'000	AVAILABLE FOR SALE £'000	DERIVATIVES DESIGNATED AS FAIR VALUE HEDGES £'000	NON- DESIGNATED DERIVATIVES £'000	
<b>31 December 2020</b>						
<b>Financial assets</b>						
Cash in hand	285	-	-	-	-	285
Balances with the Bank of England	35,942	-	-	-	-	35,942
Loans and advances to credit institutions	23,419	-	-	-	-	23,419
Debt securities	-	-	6,923	-	-	6,923
Derivative financial instruments	-	-	-	2	10	12
Loan and advances to customers	285,780	-	-	-	-	285,780
<b>Total financial assets</b>	<b>345,426</b>	<b>-</b>	<b>6,923</b>	<b>2</b>	<b>10</b>	<b>352,361</b>
Non financial assets	2,293	-	-	-	-	2,293
<b>Total assets</b>	<b>347,719</b>	<b>-</b>	<b>6,923</b>	<b>2</b>	<b>10</b>	<b>354,654</b>
<b>Financial liabilities</b>						
Shares	-	310,133	-	-	-	310,133
Amounts owed to credit institutions	-	6,002	-	-	-	6,002
Amounts owed to other customers	-	12,271	-	-	-	12,271
Derivative financial instruments	-	-	-	1,708	82	1,790
<b>Total financial liabilities</b>	<b>-</b>	<b>328,406</b>	<b>-</b>	<b>1,708</b>	<b>82</b>	<b>330,196</b>
Non financial liabilities	-	881	-	-	-	881
<b>Total liabilities</b>	<b>-</b>	<b>329,287</b>	<b>-</b>	<b>1,708</b>	<b>82</b>	<b>331,077</b>

At the year end the Society has loan commitments of £18.1m (2020: £31.8m) measured at cost.

#### FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE

The table below summarises the fair values of the Society's financial assets and liabilities that are accounted for at fair value and are grouped into levels (1 and 2) to reflect the significance of the inputs in measuring fair value:

##### Level 1

Observable market prices have been used to determine the fair value of the debt securities.

##### Level 2

The fair value for the interest rate swaps have been determined using generally observable SONIA and LIBOR yield curves derived from quoted interest rates which match the timings of the cash flows and maturities of the instruments.

#### 31 December 2021

	LEVEL 1 £'000	LEVEL 2 £'000	TOTAL £'000
<b>Financial assets</b>			
Available for sale			
Debt securities	9,399	-	9,399
Fair value through profit and loss			
Interest rate swaps	-	1,927	1,927
	<b>9,399</b>	<b>1,927</b>	<b>11,326</b>
<b>Financial liabilities</b>			
Fair value through profit and loss			
Interest rate swaps	-	307	307
	<b>-</b>	<b>307</b>	<b>307</b>

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 30. FINANCIAL INSTRUMENTS (CONTINUED)

#### FINANCIAL INSTRUMENTS CARRIED AT FAIR VALUE (CONTINUED)

31 December 2020	LEVEL 1 £'000	LEVEL 2 £'000	TOTAL £'000
<b>Financial assets</b>			
Available for sale			
Debt securities	6,923	-	6,923
Fair value through profit and loss			
Interest rate swaps	-	12	12
	<b>6,923</b>	<b>12</b>	<b>6,935</b>
<b>Financial liabilities</b>			
Fair value through profit and loss			
Interest rate swaps	-	1,790	1,790
	<b>-</b>	<b>1,790</b>	<b>1,790</b>

#### CREDIT RISK

Credit risk is the risk that counterparties will not meet their obligations as they fall due. All loan applications are assessed with reference to the Society's lending policy.

Treasury counterparties are approved and monitored by the Board.

The Society operates an experienced credit risk function, driven both by the need to manage the potential and actual risk both currently and in the future. Through this, any variations in risk resulting from market, economic or competitive changes are identified and appropriate controls and strategies are implemented.

The Society's maximum credit exposure is detailed below:

	2021 £'000	2020 £'000
Cash in hand	266	285
Balances with the Bank of England	37,483	35,942
Loans and advances to credit institutions	17,030	23,419
Debt securities	9,399	6,923
Derivative financial instruments	1,927	12
Loans and advances to customers	311,187	285,780
<b>Total statement of financial position exposure<sup>(1)</sup></b>	<b>377,292</b>	<b>352,361</b>
Off balance sheet exposure: mortgage commitments <sup>(2)</sup>	18,094	31,814
<b>Total</b>	<b>395,386</b>	<b>384,175</b>

(1) All values are stated at balance sheet amounts

(2) This reflects business that has been formally offered but has not yet completed.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 30. FINANCIAL INSTRUMENTS (CONTINUED)

#### CREDIT RISK (CONTINUED)

##### Loans and advances to credit institutions, debt securities and derivative financial instruments

The Society holds various investments in order to meet current and future liquidity regulatory requirements, as well as to satisfy operational demand. Credit risk arises due to factors such as deterioration in the counterparty's financial health and wider uncertainty within the market. Credit risk relating to treasury investments and derivative hedges is managed through setting strict upper and lower limits to each type of investment that are dependent on criteria such as, time to maturity, credit rating and originating country. These limits are set by ALCO, approved by the Board and monitored by the treasury team on a continuous basis.

Comprehensive management information on movement and performance within the treasury asset portfolios ensures that credit risk is effectively controlled, and any adverse trends are identified before they impact on performance.

There has been no change in the year to the manner in which the Society manages and measures treasury related credit risk.

An analysis of the Society's treasury concentration is shown in the tables below:

	2021 £'000	2021 %	2020 £'000	2020 %
<b>Industry sector</b>				
Unrated Building Societies	8,256	41.17%	4,256	29.73%
Rated Banks & Building Societies	2,400	11.97%	3,135	21.90%
Multinational Development Banks	9,399	46.86%	6,924	48.37%
<b>Total</b>	<b>20,055</b>		<b>14,315</b>	

The table below shows treasury exposures broken down by Fitch ratings:

	2021 £'000	2020 £'000
<b>Credit grades</b>		
AAA - AA	9,399	6,924
A+ - A	2,400	3,135
Unrated	8,256	4,256
<b>Total</b>	<b>20,055</b>	<b>14,315</b>

'Unrated' relates to investments in unrated Building Societies.

At 31 December 2021 none of the Society's treasury portfolio exposure was either past due or impaired. There are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

The largest exposure to a single institution other than the UK Government is £6.3m (2020: £3.9m).

The Majority of treasury assets held by the Society are with counterparties based within the United Kingdom such as the UK Government and UK Banks and Building Societies. The Society also holds assets issued by Multinational Development Banks located in Luxembourg and the United States. The Society does not have exposure to foreign exchange risk as all treasury assets are denominated in Sterling.

All derivative assets are issued by UK based credit institutions. The Society prefers to document its derivative activity via the International Swaps and Derivatives Association ('ISDA') Master Agreement.

##### Loans and advances to customers

The Society is committed to mitigating risk through all stages of the lending cycle. The Society assesses customer affordability and the LTV percentages of all loans at the application stage. Additionally the Society employs underwriting and fraud detection policies to minimise losses once loans have been approved as well as taking a proactive approach to the monitoring and treatment of bad and doubtful debt through the collections and recovery functions.

The Society maintains comprehensive management information on the performance and movements within the various loans portfolios to ensure that credit risk is adequately controlled, and any adverse trends are identified before they impact on performance. Society performance is benchmarked against the industry when appropriate to identify any outlying trends. This management information is distributed throughout the Society and monitored at a Board committee level.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 30. FINANCIAL INSTRUMENTS (CONTINUED)

#### CREDIT RISK (CONTINUED)

The tables below provides further information on the Society's loans and advances to customers by payment due status as at 31 December 2021, and the allowance for impairment held by the Society against those assets. The loan balances exclude the fair value adjustment for hedge risk and impairment losses. Individual assessments are made of all mortgage loans where objective evidence indicates that losses are likely (for example when loans are past due) or the property is in possession, or where fraud or negligence has been identified. Further consideration is given in accounting policy 1.7 to the accounts.

Arrears analysis	2021		2020	
	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000
<b>Collectively assessed for impairment</b>				
Not past due	297,040	3,952	269,630	5,307
Past due up to 1 month	356	-	1,073	27
<b>Total collectively assessed for impairment</b>	<b>297,396</b>	<b>3,952</b>	<b>270,703</b>	<b>5,334</b>
<b>Individually assessed for impairment</b>				
Not past due	8,031	-	7,277	-
Past due between 1 - 3 months	302	-	1,362	-
Past due between 3 - 6 months	697	-	109	-
Past due between 6 - 9 months	277	-	-	317
Past due between 9 - 12 months	-	-	61	-
Past due over 12 months	397	135	470	147
<b>Total individually assessed for impairment</b>	<b>9,704</b>	<b>135</b>	<b>9,279</b>	<b>464</b>
<b>Loans and advances to customers</b>	<b>307,100</b>	<b>4,087</b>	<b>279,982</b>	<b>5,798</b>
<b>Allowance for impairment</b>				
Collective	297	2	463	2
Individual	58	-	64	-
<b>Total allowance for impairment</b>	<b>355</b>	<b>2</b>	<b>527</b>	<b>2</b>

#### Fair value of collateral held

The Society holds collateral against each loan and advance in the form of property. The use of such collateral is in line with terms that are usual and customary to standard lending activities. Whilst the average loan-to-value (LTV; loan balance as a percentage of the collateral value) at portfolio level is below 34%, reflecting a significant level of coverage, the LTV of certain individual loans within the portfolio are higher and so have less collateral coverage. For loans with a higher LTV, the need for holding a provision against losses may be necessary should objective evidence indicates a loss event has occurred (refer to accounting policy 1.7 to the accounts).

The tables below stratify credit exposures from mortgage loans and advances to retail customers by ranges of loan-to-value (LTV) ratio. LTV is calculated as the ratio of the gross amount of the loan - or the amount committed for loan commitments - to the value of the collateral. The gross amounts exclude any impairment allowance. The valuation of the collateral excludes any adjustments for obtaining and selling the collateral. The value of the collateral for residential mortgage loans is based on the collateral value at origination updated based on changes in the Nationwide house price indices.

The indexed loan-to-value analysis on the Society's loan portfolio is as follows:

LTV ratio	2021		2020	
	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000	LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	LOANS FULLY SECURED ON LAND £'000
Less than 50%	160,617	3,109	130,864	2,719
51 - 80%	133,982	978	114,486	3,079
81 - 90%	11,151	-	31,659	-
91 - 95%	1,350	-	2,476	-
95 - 100%	-	-	497	-
Over 100%	-	-	-	-
<b>Total loans</b>	<b>307,100</b>	<b>4,087</b>	<b>279,982</b>	<b>5,798</b>

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 30. FINANCIAL INSTRUMENTS (CONTINUED)

#### CREDIT RISK (CONTINUED)

Fair value of collateral held (continued)	2021		2020	
	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON LAND £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON RESIDENTIAL PROPERTY £'000	COLLATERAL VALUE HELD AGAINST LOANS FULLY SECURED ON LAND £'000
Collectively assessed for impairment	882,485	14,958	770,243	16,873
Individually assessed for impairment:				
Not past due	27,681	-	25,364	-
Past due up to 6 months	4,012	-	3,523	-
Past due over 6 months	1,882	360	1,524	1,125
<b>Total collateral value</b>	<b>916,060</b>	<b>15,318</b>	<b>800,654</b>	<b>17,998</b>

The overall indexed loan-to-value of the residential portfolio is 33.52% (2020: 34.97%).

At the year end there were no cases of possession of assets held as collateral against loans and advances (2020: Nil).

#### Forbearance strategies

The Society continues to invest in developing and enhancing its arrears management strategies to minimise credit risk whilst ensuring that customers are treated fairly. Such forbearance strategies include the use of arrangements or renegotiation of covenants to assist borrowers in arrears who are now able to meet agreed repayment strategies, including or excluding arrears balances. Forbearance strategies aim to avoid repossession.

The tables below provides further information on loans existing at the 2021 and 2020 reporting periods by types of account renegotiations applied to our customers over the past 12 months. This includes renegotiations regardless of whether or not our customer has experienced financial difficulty in repaying their loan within the Society.

	Partial Payments £ 000	Interest Only £ 000	Total Forbearance £ 000
<b>31 December 2021</b>			
Past due up to 3 months	-	449	449
Past due more than 3 months	675	-	675
	<b>675</b>	<b>449</b>	<b>1,124</b>
<b>31 December 2020</b>			
Past due up to 3 months	131	-	131
Past due more than 3 months	295	61	356
	<b>426</b>	<b>61</b>	<b>487</b>

Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 30. FINANCIAL INSTRUMENTS (CONTINUED)

#### LIQUIDITY RISK

'Liquidity risk' is the risk that the Society will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Society's liquidity policy is to maintain sufficient funds in a liquid form at all times to ensure that it can meet its liabilities as they fall due. The objective of liquidity is to help smooth mismatches between maturing assets and liabilities and to provide protection against any unexpected events that may occur. Liquidity is monitored daily and reported to the ALCO on a weekly basis. The Society's liquidity policy is designed to provide the Society with the resources to withstand a range of stressed scenarios. A number of appropriate stressed scenarios have been identified as part of the Society's liquidity risk management. The scenarios developed include idiosyncratic, market-wide and combination stress tests, fulfilling the specific requirements of the Prudential Regulatory Authority ('PRA').

The Society's liquid resources comprise high quality liquid assets such as Gilts and investment grade fixed and floating notes issued by highly rated Multinational Development Banks. At the year end the percentage of total shares and deposits held in these high quality liquid assets was 2.66% (2020: 2.11%). In addition the Society also held deposits with UK banks and portfolio's of certificates of deposits ('CDs') and time deposits ('TDs') with other financial institutions. When taking the bank deposits, CDs and TDs into account the percentage of total shares and deposits held in liquidity resources was 18.25% (2020: 19.85%).

The tables below set out maturity analysis for financial liabilities that shows the remaining contractual maturities at undiscounted amounts. The analysis of gross contractual cash flows differs from the analysis of residual maturity due to the inclusion of interest accrued at current rates, for the average period until maturity on the amounts outstanding at the statement of financial position date.

	ON DEMAND £'000	NOT MORE THAN THREE MONTHS £'000	MORE THAN THREE MONTHS BUT NOT MORE THAN ONE YEAR £'000	MORE THAN ONE YEAR BUT NOT MORE THAN FIVE YEARS £'000	MORE THAN FIVE YEARS £'000	TOTAL £'000
<b>31 December 2021</b>						
Shares	246,700	53,974	22,037	8,571	-	331,282
Amounts owed to credit institutions	-	2,008	5,008	972	-	7,988
Amounts owed to other customers	7,994	2,067	4,054	-	-	14,115
Derivative financial instruments	-	20	54	1,016	19	1,109
Off balance sheet commitments	18,094	-	-	-	-	18,094
<b>Total financial liabilities</b>	<b>272,788</b>	<b>58,069</b>	<b>31,153</b>	<b>10,559</b>	<b>19</b>	<b>372,588</b>
<b>31 December 2020</b>						
Shares	238,127	29,229	16,713	26,524	-	310,593
Amounts owed to credit institutions	-	1,000	5,005	-	-	6,005
Amounts owed to other customers	9,269	3,003	-	-	-	12,272
Derivative financial instruments	-	5	163	1,464	41	1,673
Off balance sheet commitments	31,814	-	-	-	-	31,814
<b>Total financial liabilities</b>	<b>279,210</b>	<b>33,237</b>	<b>21,881</b>	<b>27,988</b>	<b>41</b>	<b>362,357</b>

Off balance sheet commitments pertain to amounts payable on demand for undrawn loan commitments and have been included accordingly

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 30. FINANCIAL INSTRUMENTS (CONTINUED)

#### MARKET RISK

'Market risk' is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market prices comprise three types of risk; currency risk, interest rate risk and other price risk. As the Society is not exposed to foreign currencies the primary risk associated with market prices comes from interest rate risk.

The Society is exposed to movements in interest rates reflecting the mismatch between the dates on which interest receivable on assets and interest payable on liabilities are next reset to market rates or, if earlier, the dates on which the instruments mature. The Society manages this exposure continually within approved limits by using financial instruments.

#### INTEREST RATE RISK

The Society has adopted the 'Matched' approach to interest rate risk, as defined by the PRA, operating within the exemptions permitted within section 9A of the 1986 Act. The 'Matched' approach aims to use 'standard' hedging instruments to manage the interest rate risks associated with offering fixed rate retail products, as detailed within the opening paragraph to this note. 'Standard' instruments include interest rate swaps and plain vanilla 'over the counter' ('OTC') derivatives.

The Society's interest rate risk management includes a regular review of the product to hedge instrument matches by senior management supported by monthly review by the ALCO and the board. In addition interest rate gap analysis is performed on a monthly basis and presented to the ALCO.

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Society's financial assets and financial liabilities to various standard and non-standard interest rate scenarios. The analysis therefore is also an interest rate sensitivity assessment to represent market value movement, calculated using a discounted cash flow basis on all of the Society's financial assets and liabilities. The sensitivity analysis is based on immediate 200 basis point parallel shifts in interest rates. If there was a 2% parallel upwards shift in interest rates the favourable impact on reserves would be £685,000 (2020: £314,000). All exposures include investments of the Society's reserves. Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics; say SONIA and Bank of England Base Rate) and prepayment risk (the risk of loss arising from early repayments of fixed rate mortgages and loans) are also monitored closely and regularly reported to the ALCO.

#### Derivatives held for risk management

The Society uses derivatives designated to manage certain risks it faces in accordance with section 9A of the Building Societies Act 1986. In particular the Society employs 'fair value hedges' in the form of interest rate swaps to manage the exposure to interest rate risk inherent when providing fixed rate retail products. The interest rate swaps essentially hedge the exposure to changes in the fair values of the fixed products supplied by the Society, driven by changes in market interest rates.

Activity	Risk	Fair value interest rate hedge
Fixed rate mortgage	Increase in interest rates	Society pays fixed, receives variable
Fixed rate savings	Decrease in interest rates	Society receives fixed, pays variable

The fair values of derivatives designated as fair value hedges are as follows.

	2021 ASSETS £'000	2021 LIABILITIES £'000	2020 ASSETS £'000	2020 LIABILITIES £'000
Interest rate swap	1,905	250	2	1,708

Interest rate swaps are matched to specific issuances of fixed rate retail shares or loans. All hedges are supported by comprehensive hedging documentation as per the requirement in FRS 102. The Society utilises the derivative instruments for hedging purposes only and no such instruments are used for trading activity or speculative purposes. All fair value hedges are against 3 month LIBOR.

#### Other price risk

Other price risk is the risk resulting from the possibility that the price of a security may decline. The Society's policy is to have no material exposure to equity markets. Any exposures arising from the Society's products are eliminated as far as it is practicable by appropriate hedging contracts.

## Notes to the accounts for the year ended 31 December 2021 (continued)

### 31. CAPITAL

The Society's policy is to have a strong capital base to maintain Member confidence and to sustain future growth of the business, as well as protecting against any adverse changes in economic conditions.

The formal Internal Capital Adequacy Assessment Process (ICAAP) assists the Society with its management of capital and is approved by Board at least annually. The risk appetite aims to maintain a specific level above the Total Capital Requirement (TCR) set by the industry regulator, and the capital regime incorporates Lending and Business decisions, product pricing, counterparty and concentration risks. The Society operates under the rules set and managed by the PRA and there have been no breaches during the year.

The capital held by the Society is predominantly in the form of the Society's audited reserves, disclosed as 'Common Equity Tier 1 Capital' within the capital holding summary below:

<b>Society's Capital</b>	2021	2020
Common Equity Tier 1 Capital (£m)	25.2	23.5
Collective Impairment Allowance (£m)	0.3	0.5
<b>Total Capital (Audited) (£m)</b>	<b>25.5</b>	<b>24.0</b>
Tier 1 Ratio (%)	18.8	18.3
Total Capital Ratio (%)	19.0	18.7

Further details on the Society's capital position is given in the Pillar 3 disclosures to be published on the Society's website at the same time as these accounts.

### 32. RELATED PARTY TRANSACTIONS

A related party is a person or entity that is related to the entity that is preparing its financial statements (referred to as the 'reporting entity'). This note discloses any related parties to the Society and any transactions that may have taken place.

#### Transactions with Group entities

During the year the Society's remaining two non-trading subsidiaries were liquidated. Share capital of £4 was repaid to the Society.

#### Transactions with key personnel

Key personnel are those persons that hold authority and responsibility for planning, directing and controlling the activities of the Society. The total remuneration awarded to key personnel during the year was £964,000 (2020: £965,000).

The Society ensures that its business activities are carried out at arm's length. Controls are in place to ensure that related parties are identified, such as the review of vendors at onboarding, and declarations made by Directors of the Society to prevent potential conflicts of interests.

The table below summarises the current related party transactions for the Society:

	2021		2020	
	NUMBER OF KEY PERSONNEL AND THEIR CLOSE FAMILY MEMBERS	AMOUNTS IN RESPECT OF KEY PERSONNEL AND THEIR CLOSE FAMILY MEMBERS £'000	NUMBER OF KEY PERSONNEL AND THEIR CLOSE FAMILY MEMBERS	AMOUNTS IN RESPECT OF KEY PERSONNEL AND THEIR CLOSE FAMILY MEMBERS £'000
Share and deposit accounts	15	73	13	64

### 33. COUNTRY BY COUNTRY REPORTING

#### Basis of preparation

The Capital Requirements (Country-by-Country) Regulations 2013 ("the Regulations") implement Article 89 of the Capital Requirements Directive IV ("CRD IV"), which require credit institutions and investment firms in the EU to disclose annually. The disclosures below have been prepared to comply with the requirements of the Regulations for the year ended 31 December 2021.

Vernon Building Society meets the definition of a credit institution and is classified within the retail banking category. It is registered and trades solely in the United Kingdom.

	2021	2020
Number of employees (FTE)	76	71
Turnover £m <sup>(1)</sup>	7,013	6,081
Pre-tax profit £m	2,007	891
Corporation tax paid £m <sup>(2)</sup>	197	57
Public subsidies received	Nil	Nil

1) Turnover is defined as total income (net interest receivable and net fee/commission income) in accordance with guidance from UK Treasury.

2) Corporation tax paid in 2021 is in respect of the results for the year ended 31 December 2020.

## Annual Business Statement for the year ended 31 December 2021 (unaudited)

### 1. STATUTORY PERCENTAGES

	2021 %	STATUTORY LIMIT %
Proportion of business assets not fully secured on residential property (Lending Limit)	2.26	25
Proportion of shares and borrowings not held by individuals (Funding Limit)	7.78	50

The above percentages have been calculated in accordance with the provisions of Building Societies Act 1986.

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

X = business assets, being the total assets of the Society plus provisions for bad and doubtful debts less liquid assets and tangible fixed assets as shown in the Society's Accounts.

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

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

X = Shares and borrowings being the aggregate of

- i) the principal value of, and interest accrued on, shares in the Society;
- ii) the principal of, and interest accrued on, sums deposited with the Society.

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

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

### 2. OTHER PERCENTAGES

	2021 %	2020 %
Gross capital as a percentage of shares and borrowings	7.13	7.18
Free capital as a percentage of shares and borrowings	6.78	6.80
Liquid assets as a percentage of shares and borrowings	18.17	19.73
Profit after taxation as a percentage of mean total assets	0.44	0.21
Management expenses as a percentage of mean total assets	1.40	1.49

The above percentages have been prepared from the Society's annual accounts.

Gross capital represents the general reserve together with the available-for-sale reserve as shown within the Statement of Financial Position.

Free capital represents gross capital and provisions for collective impairment losses on loans and advances to customers, less property, plant and equipment and intangible assets as shown within the Statement of Financial Position.

Shares and borrowings represent the total of shares, amounts owed to credit institutions and amounts owed to other

Mean reserves is the average of the 2021 and 2020 general reserves.

Mean total assets is the average of the 2021 and 2020 total assets.

Management expenses represent the aggregate of administrative expenses and depreciation.

## Annual Business Statement for the year ended 31 December 2021 (continued)

### 3. INFORMATION RELATING TO THE DIRECTORS AND OTHER OFFICERS AS AT 31 DECEMBER 2021

DIRECTORS	DATE OF BIRTH	DATE OF APPOINTMENT	OCCUPATION	OTHER DIRECTORSHIPS
S. Fletcher	04/1963	05.02.18	Building Society Chief Executive	-
J. Aspin	05/1970	24.11.16	Building Society Finance Director	-
J. Quirke	06/1966	04.01.18	Chartered Management Accountant	The British Show Jumping Association Q Accounting Services Ltd
P. Dillon	09/1959	14.09.20	Commercial Real Estate Lawyer	Palace Capital plc Leisure and Hotel Investments Limited
J. Hughes	02/1962	01.04.14	Company Director/Consultant	-
S. Jee	05/1955	01.12.14	Company Director Chartered Accountant	Babcock Pension Trust Ltd Magnox Ltd Magnox Electric Gp Pension Trustee Co. Ltd The Hulme Hall Trust Foundation (Trustee) Dounreay Site Restoration Ltd
M. Joyce	09/1966	02.09.19	Chartered Certified Accountant	Turkish Bank (UK) Ltd

The Executive Directors are employed on rolling contracts which were signed requiring six months notice by the Society and the individual.

EXECUTIVE DIRECTORS				
S. Fletcher			Director and Chief Executive	-
J. Aspin			Finance Director	-
OFFICERS				
V. Thackstone			Chief Risk Officer and Secretary	-
M. Purewal			Chief Digital and Information Officer	-
I. Richardson			Director of Operations	-

Correspondence to Directors should be addressed: 'Private and Confidential', Vernon Building Society, 19 St Petersgate, Stockport, Cheshire, SK1 1HF.



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