Marks and Spencer Financial Services Plc

Registration No: 1772585

Annual Report and Financial Statements for the year ended 31 December 2021

HSBC

Marks and Spencer Financial Services Plc

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Strategic Report

Principal activities

Marks and Spencer Financial Services Plc ('the Entity') is a public company incorporated in the United Kingdom. Its trading address is Kings Meadow, Chester Business Park, Chester CH99 9FB. The Entity is limited by shares.

Marks and Spencer Financial Services Plc, trading as M&S Bank, is an authorised bank under the Financial Services and Markets Act 2000, authorised by the Prudential Regulation Authority ('PRA') and regulated by the Financial Conduct Authority ('FCA'). The Entity's principal activity is the provision of retail banking financial services to both Marks and Spencer plc ('M&S plc') and non M&S plc customers.

The main products offered by the Entity are credit cards, unsecured personal loans, general insurance, savings accounts and travel money.

As part of a business transformation programme, the mortgage portfolio was transferred to HSBC UK Bank Plc ('HSBC UK') in June 2021 and the current account product, linked savings product and branch network were closed in the second half of the year.

A relationship agreement is in place with M&S plc which provides financial incentives to M&S plc for the ongoing profitable development of the Entity.

Review of the Entity's business

The Entity's business has seen recovery from the impact of the Covid-19 pandemic during the year. Restrictions imposed on businesses and individuals were lifted, however there is still disruption to trading. The most material impacts to trading have been reduced credit card spend and interest bearing balances, which are still below pre-pandemic levels. The travel money business has seen reduced turnover due to very little international travel taking place and the Entity having its bureaux network closed during the year. Releases in the Expected Credit Loss loan impairment provision occurred during the year to reflect the improved economic outlook towards the end of the year.

During the year, the Entity discontinued the lease with M&S plc on part of the Head Office building and moved to a hybrid model of working with the majority of colleagues continuing to work from home for the majority of the year. The Entity has maintained operational resilience throughout 2021 and disruption due to colleague absence resulting from the pandemic has been minimal.

Within the year, solutions to support customers in the initial phases of the pandemic, including payment holidays on credit products, were phased out as the requirement for them abated. Initiatives to support vulnerable customers have been implemented where appropriate.

Despite the challenges posed by the pandemic, the Entity has continued to work closely with M&S plc and HSBC UK to develop and drive forward an aligned strategy, leveraging the strengths and capabilities of the businesses. The joint transformation programme with M&S Plc is now underway with a continued re-positioning of the Entity. Following the closure of the branch network and moving away from physical banking, the Entity will now focus on credit, currency services and payments.

The short to medium term economic outlook has improved, however there is still some uncertainty due to inflationary pressures and ongoing supply chain disruption, with recovery from the pandemic likely to be influenced by the possible discovery of new variants of the Covid-19 virus. The Entity will continue to support customers during this period whilst ensuring that staff remain safe and operational capability is maintained.

Performance

The Entity's results for the year under review are as detailed in the income statement shown on page 18 of these financial statements.

The table below illustrates the differences in reported profit/(loss) to adjusted profit/(loss) before tax.

	2021 £m	2020 £m
Reported profit/(loss) before tax	**116**	(36)
PPI remediation	**11**	(18)
Business Transformation costs	**9**	–
Skilled person review remediation	**(5)**	22
Profit Share impact of additional remediation & business transformation costs	**(7)**	7
Adjusted profit/(loss) before tax	**124**	(25)

The Entity reported a profit before tax for the year in 2021 of £116m compared with a loss of £36m in 2020.

Excluding customer remediation and costs relating to business transformation, the business generated an adjusted profit before tax of £124m (2020: £25m loss).

The year on year adjusted movement reflects a £112m decrease in net operating income before impairment charges, a £254m decrease in loan impairment charge and a £8m decrease in operating expenses.

Adjusted operating income (adjusted for the impact of customer remediation, business transformation costs and associated impact on profit share) was £112m lower compared with 2020. The decrease in operating income is driven primarily by increased profit share due to M&S plc as a result improved business performance driven by releases in Expected Credit Loss loan impairment provisions. Credit card income continues to be impacted by interest bearing balances being lower than before the pandemic. Interest expense has reduced (£14m), with the primary driver being lower funding requirements.

The lower loan impairment charge is driven primarily by changes to Forward Economic Guidance owing to the improving economic outlook.

Adjusted operating expenses (adjusted for the impact of customer remediation and business transformation costs) are £8m lower when compared with prior year, reflecting ongoing focus on cost management within the business and the closure of current account and the branch network.

The reported year on year movement reflects a £75m decrease in net operating income before impairment charges, a £254m decrease in loan impairment charge and a £27m increase in operating expenses.

Increased operating expenses reflect an increase in PPI provisions of £29m, costs of £9m relating to business transformation and a release in the provision relating to the Skilled Person Review of Collections and Recoveries of £3m offset by lower reported costs of £8m.

Key performance indicators

The Directors use Key Performance Indicators ('KPIs') to monitor the business. As well as the income statement and the balance sheet, these indicators include measures to identify the returns on different categories of assets and the risks to which the Entity is exposed.

Financial KPIs

	2021	2020
	£'000	£'000
Profit/(Loss) Before Tax (£'000)	**115,795**	(35,659)
Adjusted profit/(loss) before tax (£'000)	**124,071**	(25,763)
Total risk-weighted assets (£'000)	**2,343,898**	2,676,933
Pre-tax return on risk-weighted assets (%)	**5.0**	(0.9)
Common equity tier 1 (%)	**16.6**	15.5
Cost efficiency ratio (%)	**58.6**	57.6
Return on tangible equity (%)	**24.0**	(6.8)
Ratio of customer advances to customer deposits (%)	**290.0**	148.7

Adjusted profit/(loss) excludes customer remediation and business transformation costs.

Pre-tax return on average risk-weighted assets is measured as adjusted profit/(loss) before tax divided by average risk-weighted assets. This has increased year on year due to the adjusted profit before tax reported in 2021.

Common equity tier 1 capital comprises shareholders' equity less regulatory deductions and adjustments. The Entity maintains a strong capital base to support the development of its business and meet regulatory capital requirements at all times. This has increased year on year due to higher capital resource held by the Entity and lower risk weighted assets.

Cost efficiency ratio is measured as total adjusted operating expenses divided by adjusted operating income (excluding profit share) before loan impairment and other credit risk provisions.

Return on tangible equity (RoTE) is defined as the adjusted profit attributable to ordinary shareholders, adjusted for Additional Tier 1 coupons, divided by average ordinary shareholders' equity, adjusted for other intangibles. The increase year on year reflects higher adjusted business performance.

Ratio of customer advances to customer deposits comprises loans and advances to customers as a ratio of the total customer deposits. This has increased year on year due to the closure of the current account product.

Non-financial KPIs monitored include employee engagement, which measures employees' emotional and intellectual commitment to the Entity, and customer satisfaction.

Significant accounting judgements

The following are the key areas of accounting judgements affecting the Entity:

- Customer remediation - this is covered in Note 22;
- Effective interest rate - this is covered in Note 15;
- Loan impairment - this is covered in Note 28.

Key judgements underpinning these have been considered by the Board.

Principal risks and uncertainties

An established risk governance framework and ownership structure ensures oversight of, and accountability for, the effective management of risk. The Entity's Risk Management Meeting takes place six times a year focusing on risk governance and providing a forward looking view of risks and their mitigation.

In carrying out its responsibilities, the Risk Management Meeting is closely supported by the Chief Risk Officer, the Chief Financial Officer, and the Head of Internal Audit and Compliance, together with other business functions on risks within their respective areas of responsibility.

Principal financial risks and uncertainties facing the Entity are credit risk, market risk and liquidity risk. These risks, the exposure to such risks and management of risk are set out in Note 28 to the financial statements.

The most important non-financial types of risk are operational risk, conduct and regulatory risk including financial crime compliance, reputational risk and cyber risk. The Directors have put in place procedures to monitor and manage these risks.

Operational risk is relevant to every aspect of the Entity's business and covers a wide spectrum of issues. Losses arising from fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the definition of operational risk. The objective of the Entity's operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with the Entity's risk appetite, as proposed by the Risk Management Committee set by the Board.

Top and Emerging Risks

Covid-19

The Covid-19 pandemic and its effect on the global economy have impacted the Entity's customers and performance. Renewed outbreaks and new Covid variants, including Omicron, emphasise the ongoing threat of Covid-19. It is possible that future variants could result in significant further tightening of UK Government restrictions, following the relaxations seen as milestones in the Government's roadmap out of lockdown were met in 2021. Concerns about the Omicron variant resulted in the UK Government introducing its Plan B measures in December 2021, including asking people to work from home if they were able to do so. These measures were subsequently removed on 26 January 2022 when the UK Government considered that the Omicron concerns had sufficiently abated. There is a material risk of a renewed decline in economic activity and financial volatility if a new variant was to necessitate the imposition of broad and long lasting lockdown measures.

HSBC Holdings plc's ('HSBC Group') Central scenario used to calculate expected credit loss ('ECL') impairment assumes that economic activity will continue to recover through 2022, surpassing peak pre-pandemic levels of GDP. It is assumed that the private sector expenditure growth accelerates, ensuring strong growth is sustained even as pandemic related fiscal support is rolled back. Higher inflation in the UK is assumed to be driven by supply disruptions and pandemic related base effects that peak in the first half of the year. There is a high degree of uncertainty associated with economic forecasts in the current environment and there are significant risks to the Central scenario related to the uncertainty around the evolution of the pandemic in the UK, associated policy responses and ongoing impacts felt from the Trade and Cooperation Agreement in place between the UK and the European Union ('EU') from 1 January 2021. For further details of our Central and other scenarios, see 'Measurement uncertainty and sensitivity analysis of ECL estimates' on page 44.

The UK Government and the Bank of England have deployed extensive measures to support the UK population. The UK economic recovery gathered pace after rapid Covid-19 vaccine rollout, however in response to increasing inflationary pressures, an interest rate rise has been seen in December 2021 and January 2022. The UK Government debt has risen and is expected to remain high into the medium term. This could eventually pose a dilemma for the Bank of England, as it faces the conflicting aims of keeping debt servicing costs contained while preventing a steep rise in inflation.

The Entity continue to support customers in the UK through measures initiated during the Covid-19 outbreak, and by supporting the UK Government schemes that focus on the parts of the economy most impacted by the pandemic.

The rapid introduction of the UK Government support schemes introduced throughout the Covid-19 pandemic has led to increased operational risks for the Entity, including complex conduct considerations, increased reputational risk and increased risk of fraud. These risks are likely to be heightened further as the UK Government support schemes are fully unwound. The Entity is focussed upon avoiding and mitigating any conduct risks that may arise from the implementation decisions that we have had to make and also those that may be created if our customers find themselves in financial difficulties as a result of Covid-19.

The impact of the pandemic on the long-term prospects of businesses in the most vulnerable sectors of the UK economy, such as retail, the leisure industry (including hospitality, tourism and hotels), transportation and commercial real estate, remains uncertain and may lead to significant credit losses on specific exposures, which may not be fully captured in ECL estimates. In addition, in times of stress, fraudulent activity is often more prevalent, leading to potentially significant credit or operational losses.

As economic conditions improve, and the UK Government support measures come to an end, there is a risk that the outputs of IFRS 9 impairment models may have a tendency to underestimate loan losses. Model outputs and management adjustments are closely monitored and independently reviewed for reliability and appropriateness prior to inclusion in the financial results. The Entity is also continuing to redevelop models used to calculate capital levels and drive business decisions. These include those related to credit risk to address new and changing regulatory requirements to internal ratings-based repair.

The operational support functions on which the Entity relies are based in a number of countries worldwide, some of which, notably India, have been particularly affected by the Covid-19 pandemic over the course of 2021. As a result of the Covid-19 outbreak, business continuity responses have been embedded and the majority of service level agreements have been maintained in locations where the Entity operates.

Despite the ongoing economic recovery, significant uncertainties remain in assessing the duration and impact of the Covid-19 outbreak, including whether any subsequent outbreaks result in a re-imposition of the UK Government restrictions, or a further lockdown. There is a risk that economic activity remains below pre-pandemic levels for a prolonged period. We continue to monitor the situation closely, and given the novel and prolonged nature of the outbreak, additional mitigating actions may be required.

To mitigate the impact of Covid-19 the Entity has:

• Successfully invoked business continuity plans to effectively manage operations under the constraints posed by the UK Government in response to the outbreak.

• Built up operational capacity rapidly in response to UK Government support measures aimed at combating the impacts of the Covid-19 outbreak and have responded to the heightened risk of fraud related to these programmes.

Information Security and Cyber Crime

The Entity and other organisations continue to operate in an increasingly hostile cyber threat environment, which requires ongoing investment in business and technical controls to defend against these threats. Key threats include unauthorised access to online customer accounts, advanced malware attacks on third-party suppliers and the exploitation of security vulnerabilities. We continually evaluate threat levels for the most prevalent attack types and their potential outcomes. To further protect the Entity and our customers we strengthened our controls to reduce the likelihood and impact of advanced malware, data leakage, infiltration of payment systems and denial of service attacks, we also provide our online customers with fraud advice including updates on the latest scams. We continue to enhance our cybersecurity capabilities, including threat detection, access control, data analytics and third-party service reviews. An important part of our defence strategy is ensuring our people remain aware of cybersecurity issues and know how to report incidents.

IBOR Transition

Following the announcement by the FCA in July 2017 that it will no longer persuade or require banks to submit rates for IBOR after 2021, the UK market, along with the Bank of England Working Group on Sterling Risk-Free Reference Rates (RFRs) has been engaged with facilitating an orderly transition of the relevant IBORS to their replacement rates.

Internal funding is priced at RFR and no rate linked products are offered to customers. The Entity has actively transitioned legacy contracts in 2021.

Financial Crime and Fraud Risk

Financial institutions remain under considerable regulatory scrutiny regarding their ability to prevent and detect financial crime. Financial crime threats continue to evolve, often in tandem with increased geopolitical developments, posing challenges for financial institutions to keep abreast of developments and manage conflicting laws. The global economic slowdown as a result of the Covid-19 outbreak is resulting in an increase in fraud risk, as fraudulent activity is often more prevalent in times of crisis. The evolving regulatory environment continues to present an execution challenge.

The Entity is strengthening and investing in fraud controls, to introduce next generation anti-fraud capabilities to protect both customers and the Entity.

Conduct and Customer Detriment

Financial institutions remain under considerable scrutiny regarding conduct of business, particularly in relation to fair outcomes for customers and orderly and transparent operations in financial markets. Regulators, prosecutors, the media and the public all have heightened expectations as to the behaviour and conduct of financial institutions. Any shortcomings or failure to demonstrate that adequate controls are in place to mitigate such risks could result in regulatory sanctions, fines or an increase in civil litigation.

We have continued to enhance our management of conduct in areas including our governance of product arrangements, the treatment of potentially vulnerable customers, encouragement of a 'Speak Up' culture and management of related third party risks.

People Risk

Our people are critical to our success and it is important that we identify, manage and mitigate any risks that might have an impact on our colleagues feeling empowered and able to thrive in their careers, as well as being able to support our customers and the communities they serve. We aim to foster a culture that proactively promotes the right colleague behaviours and conduct and that we have the right number of people with the right skills, knowledge and capabilities to be able to do the right thing for customers.

We continue to increase our focus on resource planning and employee retention to ensure we mitigate any risks around capacity and capability, as well as equipping line managers with the skills to both manage change and support their colleagues to ensure we engender a strong positive culture.

We have processes in place to identify where behaviours and conduct give us cause for concern and can mitigate the risk accordingly. Our ultimate parent company HSBC Group leads the HSBC University, which is open to our people and is focused on the development of our colleagues and supporting our leaders to create an environment for success. This is critical to retaining high-calibre individuals with the values, skills and experience for current and future roles.

Data Management

The Entity uses a large number of systems and applications to support key business processes and operations. As a result, we often need to reconcile multiple data sources, including customer data sources, to reduce the risk of error. We, along with other organisations, also need to meet external/regulatory obligations such as the General Data Protection Regulation ('GDPR'), Basel Committee for Banking Supervision ('BCBS') 239 and Basel III. We are progressively improving data quality across a large number of systems. Our data management, aggregation and oversight continues to strengthen and enhance the effectiveness of internal systems and processes.

Climate Risk

Climate risk has increased due to the pace and volume of regulatory developments, with trends focusing on formalising climate risk management, enhanced disclosure, greenwashing and integration of environmental and other ESG risks. Investors and activists are also placing greater focus on the actions and investment decisions of financial institutions relating to climate. HSBC UK has developed the capability to execute climate stress testing and scenario analysis and has delivered the Bank of England's

Climate Biennial Exploratory Scenario stress test exercise. The outputs of stress testing and scenario analysis are being used to further enhance risk management and decision making. To develop the right climate skills and culture a climate risk training programme has been delivered for all levels of employees.

Climate change can impact a number of the Entity's risk types, including:

• Transition Risk, arising from the move to a low-carbon economy through policy, regulatory and technological changes.

• Physical Risk, through increasing severity and/or frequency of severe weather events or other climatic events (e.g. sea level rises and flooding).

These risks have the potential to cause both financial and non-financial impacts for HSBC UK and the Entity. The awareness of climate risk, regulatory expectations and reputational risk have all heightened through 2021. The exposure that the Entity has to the risk has not materially heightened.

We have assessed the impact of climate risk on our balance sheet and have concluded that there is no material impact on the financial statements for the year ended 31 December 2021. We considered the impact on expected credit losses, classification and measurement of financial instruments, as well as our going concern.

Stakeholder Engagement and Section 172 statement

This section forms our Section 172 statement and addresses the requirements of the Companies (Miscellaneous Reporting) Regulations 2018. As set out in Section 172 of the UK Companies Act 2006 (the 'Act'), the Directors must act in good faith to promote the success of the company for the benefit of its members as a whole. In performing their duty, under the Act, the Board is required to have full regard to, amongst other things: the interests of our colleagues; the impact of our operations on the community and environment; the need to foster the bank's business relationships with suppliers, customers and others; and the need to nurture our relationship with key stakeholders in order to maintain a reputation for high standards of business conduct and enhance the sustainable long term success of the business. The Directors give careful consideration to the factors set out above in discharging their duties.

The Directors are supported in the discharge of their duties by:

- An induction programme and ongoing training to provide an understanding of our business, financial performance and prospects;
- Management, who present proposals to the Board and Committee meetings for decision, include relevant information to enable them to determine the action that would most likely promote the success of the bank; and
- Agendas for the Board and Committee meetings which are structured to provide sufficient time for the consideration and discussion of key matters.

Stakeholder Engagement

Building strong relationships with stakeholders enables the Entity to deliver the strategy in line with long term values and operate the business in a sustainable way. Stakeholders are the people who work for us, bank with us, own us, supply us and regulate us. Due to the nature of the relationship with them, M&S plc are considered to be a key stakeholder in this regard.

The Entity continues to evaluate our longer term strategy in light of Covid-19 and the interest rate environment, considering the office footprint and supporting colleagues with a shift to a more location agnostic working model. The Entity is accelerating the roll-out of digital capabilities and functionality that helps customers to self-serve and has supported customers through the closure of the current account proposition and M&S Bank branches.

Employees

People continue to show great resilience despite the prolonged challenging environment we operated within. There remains a strong focus on managing the impacts of the Covid-19 crisis on our people's safety and wellbeing, including the continuation of remote working at scale, to help colleagues remain safe and productive.

A structured communications approach uses leadership communications, campaigns and a regular flow of news to help colleagues to serve our customers better, make sense of our strategy, focus on our commercial priorities and provide clarity on issues. A sense of pride and purpose has been built by recognising colleagues' contributions to the Entity and celebrating achievements.

Understanding how colleagues feel is vital. It helps to ensure that the right support is given to fulfil their potential and do the right thing for customers. Colleagues are asked for feedback and encouraged to speak up. We do this principally through our employee survey, 'Snapshot', and quarterly 'Exchange' sessions. Snapshot results are presented to the Executive Committee and Board to ensure the attitudes and sentiments of people inform decision-making at all levels of the business and action can then be taken to tackle areas of concern. Exchange sessions allow employees to discuss what matters to them, share views and suggest ideas, while managers and leaders attend to listen. Insight shows us that where our people participate in Exchanges they are generally more positive about their experience with the Entity. They feel better able to speak up, are more trusting of managers and leaders, and report higher levels of wellbeing.

Examples of how the Board has engaged with employees during 2021 include:

- CEO Reports to the Board providing updates on employee related activities and events, metrics on employee attrition, gender diversity and personal conduct cases and the bi-annual internal employee surveys ("Snapshot"). These allowed the Board to understand employee sentiment, health and wellbeing throughout 2021.
- Consideration from the Board of strategic implications of the prolonged period of remote working arrangements and how this might impact future employee working preferences.
- Receiving an update on the Diversity & Inclusion initiatives within the Entity and ensuring that the right support and resource was in place to set the Diversity & Inclusion agenda up for success.

Suppliers

Suppliers provide critical support to help us operate our business effectively. We work with our suppliers to ensure mutually beneficial relationships. Examples of Board engagement during 2021 included:

Management reporting on the continuing potential impact to suppliers and the supply chain arising from the UK's withdrawal from the EU and Covid-19. This allowed the Board to assess the effectiveness of our relationships with third party suppliers and remain alert to pressure they may be under.

Customers

Customer needs are central to the Entity's business and must be understood so that we can appropriately support them. How we have served and supported our customers during 2021 is included throughout the Strategic Report. This has included actively supporting customers through government schemes and non-government scheme lending, as well as providing flexibility in the existing products. Support measures include providing payment holidays on Mortgages, Personal Loans and Credit Cards. Digital technology roll-out has been accelerated to provide faster processing and enable more functionality to be accessed remotely.

Ensuring customer feedback is actioned and communicated back to our customers has remained a priority for us in 2021, particularly in light of the challenging conditions created by the pandemic. Dedicated members of staff have been focussed on contacting customers who either flag issues through our feedback mechanisms to ensure a resolution is found, or who are promoters of the business to thank them for their feedback and to learn from these positive experiences. Examples of how the Board has engaged with customers includes:

- CEO Reports to the Board provided key customer related metrics and performance indicators, such as customer survey feedback and net promoter scores, which allowed the Board to monitor performance and impact.
- Reports to the Board on the transformation of the business and the impacts this had on customers, covering issues, such as complaints, the continuing impact of Covid-19 on customers and supporting vulnerable customers.
- The Board were particularly keen to ensure that the product propositions being delivered through M&S stores continued to be well governed to continue to deliver fair outcomes for customers.

HSBC UK

A strong relationship is maintained with HSBC UK through cross-directorships of the Chairman of the Board and one of the non-executive Directors. Matters to escalate to HSBC UK remains a standing agenda item to ensure that all key issues are reported to our sole shareholder in a timely manner and to ensure that key business decisions are aligned with the HSBC UK strategy.

As a wholly owned subsidiary, the Entity also benefits from certain engagement practices which take place at a HSBC Group level which allow the Entity to have more efficient and effective engagement practices. For details on some of the engagement that takes place with stakeholders at a Group level, please see the HSBC Holdings plc 2021 Annual Report and HSBC Holdings plc Environmental, Social and Governance Update.

Examples of how the Board has engaged with HSBC UK includes:

Providing the HSBC UK Board with a detailed overview of the Entity's transformation programme ahead of the decision being taken to close the M&S Bank branch network and withdrawal from the current account market.

Marks and Spencer plc

The relationship with M&S plc is valued and appropriate steps are taken to ensure that M&S plc are kept up to date on key business activities and decisions. A committee comprising membership from Marks and Spencer Financial Services plc and M&S plc exists to oversee the Bank's business and ensure that this is carried out and in accordance with the principles in the relationship agreement. The Committee sets and monitors the strategy and ongoing development of the business. The Board remains appraised of the relationship with M&S plc through the CEO and management's reporting.

Consideration of Stakeholders in Principal Decisions and Discussions

The Board delegates authority for day-to-day management of the Entity to the executive team and engages management in setting, approving and overseeing execution of the Entity's strategy and related policies. Management conducts much of the Entity's primary engagement with both internal and external stakeholders, with the outputs of this engagement activity providing critical insight and perspective for the Board when taking decisions or challenging management in respect of decisions made on behalf of the Entity.

Depending on the nature of the issue in question the relevance of each stakeholder group may differ. Board decisions will not necessarily result in a positive outcome for all of our stakeholders, but by considering our purpose, vision and values, and having due regard for stakeholder relationships, the Board aims to ensure that its decisions promote the long term success of the Entity.

A significant area of the Board and Management's focus was progressing with M&S Bank's transformation programme, which is central to the M&S Bank's ability to meet its strategic ambition. During 2021, the Board continued to oversee and input on the execution of the transformation in line with the agreed strategy and timelines. This included the delivery of new propositions for our customers, increasing digital functionality and simplifying platforms, the closure of the current account proposition and transfer of the M&S Bank Mortgage portfolio to HSBC UK, amongst others. During its discussions, the Board considered whether the impacts to, and outcomes for, our stakeholders were appropriate. The Board examined in particular whether:

- The transformation would deliver positive outcomes, such as improved digital journeys and functionalities for customers, as well as ensuring customers were appropriately supported in light of the decision to close M&S Bank branches. Particular focus from the Board was on ensuring that vulnerable customers and those in financial difficulty were supported through the process;
- The reliance on shared funding and resources from the HSBC Group could put elements of the programme at risk;
- Any dependencies with M&S plc was adequately considered and that positive outcomes for both M&S Bank and M&S plc would be delivered;

- There were appropriate support, training and opportunities for employees whose roles had been impacted. The Board was particularly keen to understand the communication strategy that was in place given the challenging external environment people continued to operate within;
- Management continued to foster and maintain an open, proactive and constructive relationship with regulators through each phase of the programme; and
- Management had taken appropriate account of the costs, risks, controls and resourcing required to support the engagement and use of external suppliers.

On behalf of the Board

Phillip Scott

P W Scott
Director

25th February 2022

Kings Meadow
Chester Business Park
Chester CH99 9FB

Report of the Directors

Directors

The Directors of the Entity who were in office during the year and up to the date of signing the financial statements were as follows:

Name
P M Spencer
J Coyle
P W Scott
D Lister

The Articles of Association of the Entity provide that in certain circumstances the Directors are entitled to be indemnified out of the assets of the Entity against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 2006. Indemnity provisions of this nature have been in place during the financial year but have not been utilised by the Directors. All Directors have the benefit of Directors' and officers' liability insurance.

Dividends

The Directors recommend the payment of a dividend in respect of the year ended 31 December 2021 of £27m (£0.10p per share) (2020: £nil). Total distributions of £5.0m in respect of Additional Tier 1 capital were paid during 2021 (2020: £5.0m).

Significant events since the end of the financial year

A dividend in respect of the year ended 31 December 2021 of £27m is recommended by the Directors.

Future developments and Current Performance

The Entity's performance during the year is covered in the Strategic Report. The Entity will continue to support colleagues and customers during the pandemic whilst continuing to work with M&S plc on strategic initiatives.

Certain information that is required in the report of Directors under the Companies Act has been described in the Strategic Report on page 1.

Going concern basis

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Entity have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources. These considerations include stressed scenarios that reflect the increasing uncertainty that the global Covid-19 pandemic has had on the HSBC operations, as well as considering potential impacts from other top and emerging risks, and the related impact on profitability, capital and liquidity.

Financial Risk Management

The financial risk management objectives and policies of the Entity, together with an analysis of the exposure to such risks, as required under Part 1 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, are set out in Note 28 of the Notes on the financial statements.

Diversity and inclusion

The Entity is committed to building a culture where individuals are valued, respected and supported; where different ideas, backgrounds, styles and perspectives are actively sought out to create business value; and where career advancement is based on objective criteria. Focus continues on the diversity profile of our workforce to help ensure it is reflective of the communities in which we operate and the customers we serve.

Diversity and inclusion carries the highest level of executive support, and oversight of our diversity agenda and related activities resides with the Diversity and Inclusion Committee.

Employment of people with a disability

The Entity is committed to providing equal opportunities to employees. The employment of people with a disability is included in this commitment. The recruitment, training, career development and promotion of people with a disability are based on the aptitudes and abilities of the individual. Should employees become disabled during employment with us, efforts are made to continue their employment and, if necessary, appropriate training, reasonable equipment and facilities are provided.

Employment policy

The Entity continues to regard communication with its employees as a key aspect of its policies. Information is given to employees about employment matters and about the financial and economic factors affecting the Entity's performance through management channels, oral communication and by way of attendance at internal seminars and training programmes. Employees are encouraged to discuss operational and strategic issues with their line management and to make suggestions aimed at improving performance. The involvement of employees in the performance of the Entity is further encouraged through a profit participation scheme.

Capital management

The Entity defines capital as total shareholder's equity. It is the Entity's objective to maintain a strong capital base to support the business strategy and to meet regulatory capital requirements at all times. The PRA, as the regulator of the Entity, sets capital requirements and receives information on the capital adequacy of the Entity. The Entity complied with the PRA's capital adequacy requirements throughout 2021.

The Entity's policy and practice in capital measurement and allocation is underpinned by the Capital Requirements Regulation ('CRR') and Capital Requirements Directive IV ('CRD IV') rules and any national discretions applied by the PRA. CRD IV legislation implemented Basel III in the EU, and in the UK, the 'PRA Rulebook' for CRR firms transposed the various discretions under CRD IV legislation into UK requirements. The Basel III framework is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. Basel III also includes a number of capital buffers, including the Capital Conservation Buffer ('CCB'), Countercyclical Capital Buffer ('CCyB'), and other systemic buffers such as the Global/Other Systemically Important Institutions ('G-SII'/'O-SII') buffer.

Pillar 3 of the Basel regulatory framework is related to market discipline and aims to make firms more transparent by requiring them to publish specific details of their risks and capital, and how these are managed. Separate Pillar 3 disclosures are not required for the Entity as the Entity is included in the consolidated Pillar 3 disclosures of HSBC UK Bank plc. These disclosures are published as a separate document on HSBC UK Bank plc's website.

Regulatory capital (audited)

The Entity's capital base is divided into three main categories namely common equity tier 1, additional tier 1 and tier 2, depending on the degree of permanency and loss absorbency exhibited.

- Common equity tier 1 capital is the highest quality form of capital, comprising shareholders' equity adjusted for various regulatory deductions. These include deductions of the excess of expected loss amounts calculated under the Internal Ratings Based ('IRB') approach using the firm's own data, over and above the equivalent accounting provision and intangible assets and an IFRS 9 transitional add-back adjustment.
- Additional tier 1 capital comprises non-common equity capital securities which by nature of their terms are eligible for inclusion in the firm's capital base under CRD IV rules.
- Tier 2 comprises subordinated loans and any excess of accounting provision over equivalent IRB expected loss, subject to a cap of 0.6% of risk weighted assets.

Calculation of actual capital

	2021	2020
	£'000	£'000
Tier 1 capital		
Shareholders' equity[1]	**379,520**	316,421
Deductions		
- Adjustment for intangible assets	**(202)**	(773)
- IFRS 9 transitional add-back	**9,726**	99,717
Common equity tier 1 capital	**389,044**	415,365
Issue of additional tier 1 instrument (note 25)	**69,000**	69,000
Tier 1 capital	**458,044**	**484,365**
Tier 2 capital		
Total qualifying tier 2 capital before deductions		
- Collective impairment allowances	**10,711**	11,413
- Term subordinated debt (Note 23)	**95,000**	95,000
Tier 2 capital	**105,711**	106,413
Total regulatory capital	**563,755**	590,778
Risk-weighted assets (Unaudited)		
Credit and counterparty risk	**1,952,623**	2,210,801
Operational risk	**391,275**	466,132
Total	**2,343,898**	2,676,933
Capital ratios (%) (Unaudited)		
Common equity tier 1 ratio	**16.60**	15.52
Tier 1 ratio	**19.54**	18.09
Total capital ratio (Unaudited)	**24.05**	22.07

[1] *Includes reported profit for 2021 and foreseeable dividend proposed in respect of 2021*

Corporate Governance Statement

The Entity is committed to high standards of corporate governance. As an ultimate subsidiary of HSBC Group which complies with the provisions of the UK Corporate Governance Code, the Entity adopted the HSBC Group's Subsidiary Accountability Framework ('SAF') in 2021. The SAF Principles set out the Group's high level expectations for corporate governance arrangements in its subsidiaries. The Entity and its Board considers SAF to be sufficiently comprehensive and robust and has therefore chosen not to adopt another corporate governance code.

During the year ended 31 December 2021 and up to the date of this report, the Entity complied with SAF and HSBC Group policies, frameworks and procedures in addition to its relevant legal and regulatory governance requirements, including the PRA Rulebook for Ring-Fenced Bodies.

How the Directors have Regard to Key Stakeholders and Employees

As described on page 5, the Board considers feedback from engagement exercises with employees and key stakeholders throughout the year. It also has regard to the interest of these stakeholders when considering and approving the Entity's annual operating plan, risk appetite statement, and capital and operating plans, through robust challenge of management's proposals and plans to achieve the Company's strategic objectives, financial targets and key performance indicators. Further details on how the Directors have engaged with employees and had regard to their interests, and the need to foster the company's business relationships when making decisions can be found on pages 5 to 6.

Independent auditors

PricewaterhouseCoopers LLP ('PwC') are the external auditors to the Entity. PwC has expressed its willingness to continue in office and the Board recommends that PwC be re-appointed as the Entity's auditors.

Statement of Directors' responsibilities in respect of the financial statements

The following statement, which should be read in conjunction with the auditor's statement of their responsibilities set out in their report on pages 12 to 15, is made with a view to distinguish the respective responsibilities of the Directors and of the auditors in relation to the financial statements.

The Directors are responsible for preparing the *Annual Report and Financial Statements*, and the financial statements in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with UK-adopted international accounting standards.

Under company law, Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Entity and of the profit or loss of the Entity 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 UK-adopted international accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Entity will continue in business.

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

The Directors are also responsible for keeping adequate accounting records that are sufficient to show and explain the Entity's transactions and disclose with reasonable accuracy at any time the financial position of the Entity and enable them to ensure that the financial statements comply with the Companies Act 2006.

Directors' Confirmations

In the case of each director in office at the date the Directors' report is approved:

- so far as the Director is aware, there is no relevant audit information of which the Entity's auditors are unaware; and
- they have taken all the 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 company's auditors are aware of that information.

Disclosure of Information to Auditors

In accordance with section 418 of the Companies Act 2006, the Directors' report includes a statement in the case of each Director in office as at the date the Report of the Directors is approved, that:

- so far as the Director is aware, there is no relevant audit information of which the Entity's auditors are unaware; and
- they have taken all the steps they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Entity's auditors are aware of that information.

On behalf of the Board

Phillip Scott

P W Scott
Director
25th February 2022

Kings Meadow
Chester Business Park
Chester CH99 9FB

Independent auditors' report to the members of Marks and Spencer Financial Services Plc

Report on the audit of the financial statements

Opinion

In our opinion, Marks and Spencer Financial Services Plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2021 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with UK-adopted international accounting standards; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report") which comprise:

- the income statement for the year ended 31 December 2021;
- the statement of comprehensive income for the year ended 31 December 2021;
- the balance sheet as at 31 December 2021;
- the statement of cash flows for the year ended 31 December 2021;
- the statement of changes in equity for the year ended 31 December 2021; and
- the notes on the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Board of Directors.

Basis for opinion

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

Independence

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

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

Other than those disclosed in Note 8, we have provided no non-audit services to the company in the period under audit.

Our audit approach

Overview

Audit scope

- Marks and Spencer Financial Services Plc is a member of the HSBC Group, the ultimate parent company of which is HSBC Holdings plc. Marks and Spencer Financial Services Plc operates in the UK.
- We performed an audit of the complete financial information of one reporting unit namely Marks and Spencer Financial Services Plc.

Key audit matters

- Expected Credit Loss ('ECL') provision for loans and advances
- Recognition of income under Effective Interest Rate ('EIR') accounting

Materiality

- Overall materiality: £5,000,000 (2020: £4,000,000) based on 5% of 4-year average adjusted profit before tax.
- Performance materiality: £3,750,000 (2020: £3,000,000).

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the 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) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by our audit.

The following, which were key audit matters last year are no longer included:

- Customer Redress - Payment Protection Insurance ('PPI') and the Conduct Matter, due to the fact that for both matters, the quantum of the provisions and associated level of estimation uncertainty has reduced over the course of 2021.
- Information Technology ('IT') Access Management, because management has remediated a number of the control deficiencies in relation to IT Access Management.
- The impact of Coronavirus disease (Covid-19), because we deem the overall risk and uncertainty around Covid-19 to have reduced over the past year, as the potential impacts have become better understood, so that our consideration of this area in the current year is adequately captured by our other key audit matters.

Otherwise, the key audit matters below are consistent with last year.

Expected credit loss ('ECL') provision for loans and advances

Nature of key audit matter	Matters discussed with the Board of Directors
Determining expected credit losses ('ECL') involves management judgement and is subject to a high degree of estimation uncertainty. Management makes various assumptions when estimating ECL. The significant assumptions that we focus on in our audit included those with greater levels of management judgement and for which variations had the most significant impact on ECL. Specifically these included: • Forward looking economic scenarios and their probability weightings; and • Certain management judgemental adjustments. The impact of Covid-19, including the nature and extent of government support, and more recent factors, including supply chain constraints and increasing inflation, have resulted in unprecedented economic conditions that vary across industries. This leads to uncertainty around judgements made in determining the severity and probability weighting of macroeconomic variable ('MEV') forecasts across the different economic scenarios used in ECL models. The modelling methodologies used to estimate ECL are developed using historical experience. The impact of the unprecedented economic conditions has resulted in certain limitations in the reliability of these methodologies to forecast the extent and timing of future customer defaults and therefore estimate ECL. In addition, modelling methodologies do not incorporate all factors that are relevant to estimating ECL, such as differentiating the impact on customer segments of economic conditions. These limitations are addressed with management adjustments, the measurement of which is inherently judgemental and subject to an increased level of estimation uncertainty.	We held discussions with the Board of Directors covering governance and controls over ECL, with a significant focus on judgemental adjustments. Our discussions included: • The severity of MEV forecasts in economics scenarios, and their related probability weightings; • Management judgemental adjustments and the nature and extent of analysis used to support those adjustments; • The criteria and conditions used to assess to what extent management judgemental adjustments continue to be needed; and • The disclosures made to explain ECL, in particular the impact of adjustments on determining ECL and the resulting estimation uncertainty.

How our audit addressed the key audit matter

We assessed the design of controls and governance over the estimation of ECLs, as well as testing how effectively they operated. We observed management's governance forums for (1) the determination of MEV forecasts and their probability weightings for different economic scenarios, and (2) the assessment of ECL, including the assessment of model limitations and approval of any resulting adjustments to modelled outcomes.

We also tested controls over:

- Model validation and monitoring;
- The input of critical data into source systems and the flow and transformation of critical data from source systems to impairment models and management judgemental adjustments; and
- The calculation and approval of management judgemental adjustments to modelled outcomes.

We involved our economic experts to assist in assessing the reasonableness of the severity and probability weighting of MEV forecasts. These assessments considered the sensitivity of ECLs to variations in the severity and probability weighting of MEVs for different economic scenarios. We involved our modelling experts in assessing the appropriateness of the significant assumptions and methodologies used for models and management judgemental adjustments. We independently reperformed the calculations for a sample of those models and management judgemental adjustments. We further considered whether the judgements made in selecting the significant assumptions would give rise to indicators of possible management bias.

In addition, we performed testing over:

- The compliance of ECL methodologies and assumptions with the requirements of IFRS 9;
- The appropriateness and application of the quantitative and qualitative criteria used to assess significant increases in credit risk; and
- A sample of critical data used in the year end ECL calculation and to estimate management judgemental adjustments as at 31 December 2021.

We evaluated and tested the Credit Risk disclosures made in the financial statements.

Relevant references in the Annual Report and Financial Statements 2021

Note 1: Basis of preparation and significant accounting policies, Impairment of amortised cost financial assets, page 25 - 27.
Note 28 : Management of financial risk, Credit risk management, pages 42 - 52.

Recognition of income under Effective Interest Rate ('EIR') accounting

Nature of key audit matter	Matters discussed with the Board of Directors
Loans and advances are recognised at amortised cost, with the associated interest income recognised using the Effective Interest Rate ('EIR') method. The majority of interest income relates to contractual interest, which is automatically calculated by the loan administration systems and requires no management intervention or judgement. EIR accounting requires management to recognise income and expenses directly related to a loan over its expected life. The most significant and judgemental area where EIR accounting is applied is in relation to credit cards, where interest income is recognised over the period that a customer is expected to have the credit card, including interest free promotional periods, which results in an EIR asset being recognised. Management uses their judgement and the performance of historic credit card portfolios to estimate customer spending levels, the total interest income expected to be earned, and the expected period that customers will use their credit cards. Changes in these behavioural assumptions could have a material impact on the EIR calculations and hence the interest income recognised. The Covid-19 pandemic continues to impact the way that customers have used their credit cards. Although customer spending levels have increased towards pre-pandemic levels, management have considered the changes in customer behaviour and where required have updated their assumptions.	Discussions with the Board of Directors focused on the key judgements and assumptions including the level of expected customer balances, interest yield forecasts, the expected behavioural life of customer accounts and consideration as to how historic experience is consistent with that expected in the future. We discussed the impact of Covid-19 and the impact on customer behaviour and future projections of spending levels.

How our audit addressed the key audit matter

- Tested the controls over data inputs in the model and substantively tested the completeness of the data feeding into the model,
- Observed management's governance meetings for the setting, challenge and approval of key assumptions, including monitoring of actual trends compared to forecast assumptions;
- Used our risk modelling experts to review and assess the model code logic used in the EIR calculation, including independently running a sample of input data through the model and comparing to management's output;
- Critically assessed and challenged the appropriateness of the key assumptions, including expected behavioural life of customer accounts and assessing whether the use of customer balance and yield curves based on historic data were appropriately reflective of current behaviour, supported by external sources;
- Performed sensitivity analysis of key assumptions to understand the materiality of the impact that potential realistic changes in assumptions may have on the EIR asset; and
- Performed testing over the reasonableness of behavioural adjustments in the year, and the impact on customer behaviour trends.

We evaluated and assessed the sufficiency of the disclosures in the financial statements relating to significant assumptions made in the EIR calculation.

Relevant references in the Annual Report and Financial Statements 2021

Note 1: Basis of preparation and significant accounting policies, Financial instruments measured at amortised cost, Pages 24 - 25.
Note 15: Loans and advances to customers, pages 35 - 36.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

During our scoping, as part of considering the impact of climate change in our risk assessment, we discussed with management the impact of climate change, including their conclusion that there is no material impact on the financial statements.

At the planning stage we updated our understanding of the entity and its environment, considering the company's governance structures, accounting framework, selection of accounting policies, applicable laws and regulations, and the company's objectives and strategies. We updated our understanding of the internal control environment, including in relation to IT.

Based on these initial audit planning procedures, we performed our risk assessment at the account balance and assertion level, considering risks of material misstatement through fraud or error.

The scope of our audit and the nature, timing and extent of our audit procedures were designed, planned and executed with consideration of our risk assessment, the financial significance of account balances, and other qualitative factors (e.g. history of error or misstatements). We performed audit procedures over all account balances and disclosures which we considered to be material and/or represent a risk of material misstatement to the financial statements.

Materiality

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

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall company materiality	£5,000,000 (2020: £4,000,000).
How we determined it	5% of 4-year average adjusted profit before tax
Rationale for benchmark applied	Adjusted profit before tax is the primary measure used by the company and the shareholder in assessing the performance of the company and removes the impact of significant items that distort year-on-year comparisons. In determining overall materiality, we have made adjustments, including for the impact of certain customer redress programmes as they are large items unrelated to the underlying performance of the company. Whilst adjusted profit before tax is still considered the most suitable benchmark, we have used a 4 year average to reduce the impact Covid-19 has had on performance in 2021.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% (2020: 75%) of overall materiality, amounting to £3,750,000 (2020: £3,000,000) for the company financial statements.

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

We agreed with the Board of Directors that we would report to them misstatements identified during our audit above £250,000 (2020: £200,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

- Performed a risk assessment to identify factors that could impact the going concern basis of accounting, including risks to the financial and operating performance of the company.
- Understanding and evaluating the company's financial forecasts and the company's stress testing of liquidity and regulatory capital, including the severity of the stress scenarios that were used.
- Reading and evaluating the adequacy of the disclosures made in the financial statements in relation to going concern.

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 company'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.

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.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the company's ability to continue as a going concern.

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

Reporting on other information

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

In connection with our audit of the financial statements, 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 audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Report of the Directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Report of the Directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Report of the Directors for the year ended 31 December 2021 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Report of the Directors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

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

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

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

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

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to the Financial Conduct Authority's ('FCA') regulations, the Prudential Regulation Authority's ('PRA') regulations and UK tax legislation, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, and management bias in accounting estimates. Audit procedures performed by the engagement team included:

- Challenging estimates and judgements made by management in their significant accounting estimates, in particular in relation to the expected credit loss provisions of loans and advances to customers and EIR accounting (see related key audit matters).
- Identifying and testing journal entries, including those posted with certain descriptions, backdated journals which positively impact the income statement, posted by infrequent and unexpected users and posted in infrequently used accounts.
- Review of correspondence with regulators including the FCA and PRA, enquiries of management, enquiries of legal and review of internal audit reports in so far as they related to the financial statements.
- Agreeing financial statement disclosures to underlying supporting documentation.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements.

Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

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

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

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

We were appointed by the directors on 17 May 2015 to audit the financial statements for the year ended 31 December 2015 and subsequent financial periods. The period of total uninterrupted engagement is 7 years, covering the years ended 31 December 2015 to 31 December 2021.

Chris Shepherd.

Chris Shepherd (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
25th February 2022

Financial statements

Income statement for the year ended 31 December 2021

	Notes	2021 £'000	2020 £'000
Interest income		**181,608**	197,750
Interest expense		**(18,162)**	(32,532)
Net interest income	2	**163,446**	165,218
Fee and commission income		**70,000**	64,207
Fee and commission expense		**(25,882)**	(27,909)
Net fee income	2	**44,118**	36,298
Other operating income	3	**527**	33,331
Other operating expense	4	**(48,371)**	–
Net operating income before change in expected credit losses and other credit impairment charges		**159,720**	234,847
Change in expected credit losses and other credit impairment charges	2	**97,747**	(155,851)
Net operating income		**257,467**	78,996
Employee compensation and benefits	5	**(43,500)**	(44,481)
General and administrative expenses	2	**(93,334)**	(65,727)
Depreciation of property, plant and equipment	16	**(978)**	(629)
Amortisation of intangible assets	17	**(791)**	(529)
Depreciation of right-of-use assets	27	**(3,069)**	(3,289)
Total operating expenses		**(141,672)**	(114,655)
Operating profit/(loss)		**115,795**	(35,659)
Profit/(loss) before tax		**115,795**	(35,659)
Tax (expense)/credit	9	**(22,233)**	8,374
Profit/(loss) for the year		**93,562**	(27,285)

Profit/(loss) after tax arises from:

	2021 £'000	2020 £'000
Continuing Operations	**100,098**	(20,683)
Discontinued Operations[1]	**(6,536)**	(6,602)

[1] *Discontinued operations are shown in note 13*

Statement of comprehensive income for the year ended 31 December 2021

	2021 £'000	2020 £'000
Profit/(loss) for the year	**93,562**	(27,285)
Total comprehensive income/(expense) for the year	**93,562**	(27,285)

There has been no comprehensive income or expense other than the profit for the year as shown above (2020: nil). This includes results attributable to the discontinued operations for the year (2020: none).

Balance sheet at 31 December 2021
Registration No: 1772585

	Notes	2021 £'000	2020 £'000
Assets			
Cash and balances at central banks		**5,013**	10,365
Items in the course of collection from other banks		**9,028**	9,267
Loans and advances to banks	*14*	**908,547**	1,613,658
Loans and advances to customers	*15*	**3,147,992**	3,239,177
Prepayments and accrued income		**3,343**	2,872
Other assets	*18*	**102,389**	169,910
Current tax assets		**–**	10,791
Property, plant and equipment	*16*	**679**	1,480
Right-of-use assets	*27*	**12,175**	17,380
Intangible assets	*17*	**3,659**	1,007
Deferred tax assets	*10*	**12,756**	12,207
Total assets		**4,205,581**	5,088,114
Liabilities and equity			
Liabilities			
Deposits by banks	*19*	**2,400,000**	2,260,034
Customer accounts	*20*	**1,085,433**	2,178,589
Items in the course of transmission to other banks		**1,599**	3,275
Accruals, deferred income and other liabilities	*21*	**81,503**	72,629
Current tax liabilities		**12,470**	–
Provisions	*22*	**52,690**	92,361
Subordinated liabilities	*23*	**96,367**	95,164
Total liabilities		**3,730,062**	4,702,052
Equity			
Called up share capital	*25*	**260,000**	260,000
Other equity instruments	*25*	**69,000**	69,000
Retained earnings		**146,519**	57,062
Total equity		**475,519**	386,062
Total liabilities and equity		**4,205,581**	5,088,114

The accompanying notes on pages 21 to 56 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 25th February 2022 and signed on its behalf by:

Phillip Scott

P W Scott
Director

Statement of cash flows for the year ended 31 December 2021

	Notes	2021 £'000	2020 £'000
Cash flows from operating activities			
Profit/(loss) before tax		**115,795**	(35,659)
Adjustments for:			
Non-cash items included in profit before tax	11	**(175,023)**	13,548
Change in operating assets[1]	11	**664,424**	313,721
Change in operating liabilities[2]	11	**(1,082,413)**	22,406
Tax credit received/(paid)		**708**	(33,160)
Net cash (used in)/generated from operating activities		**(476,509)**	280,856
Cash flows from investing activities			
Purchase of property, plant and equipment		**(176)**	(563)
Purchase of intangible assets		**(3,443)**	(993)
Adjustment of leases		**2,137**	—
Net cash used in investing activities		**(1,482)**	(1,556)
Cash flows from financing activities			
Proceeds from Borrowings		**149,967**	(720,005)
Distribution on other equity instruments (AT1)		**(5,003)**	(5,003)
Net cash generated from/(used in) financing activities		**144,964**	(725,008)
Net decrease in cash and cash equivalents		**(333,027)**	(445,708)
Cash and cash equivalents brought forward[1]		**800,015**	1,245,723
Cash and cash equivalents carried forward[3]	11	**466,988**	800,015

1. *Operating assets movement includes of £231m change in Loans and advances to customers and £366m change in Loans and advances to banks.*
2. *Operating liabilities movement includes £722m Current Account balance, £48m Monthly Saver balance and £208m Everyday Saver balance.*
3. *At 31 December 2021 £4.3m (2020: £4.1m) was not available for use by the Entity as it relates to mandatory deposits at central banks.*

Statement of changes in equity for the year ended 31 December 2021

	Called up share capital £'000	Other equity instruments £'000	Retained earnings £'000	Total equity £'000
At 1 Jan 2021	**260,000**	**69,000**	**57,061**	**386,061**
Profit for the year	**–**	**–**	**93,562**	**93,562**
Distribution on other equity instrument	**–**	**–**	**(5,003)**	**(5,003)**
Net impact of equity-settled share-based payments	**–**	**–**	**899**	**899**
At 31 Dec 2021	**260,000**	**69,000**	**146,519**	**475,519**

	Called up share capital £'000	Other equity instruments £'000	Retained earnings £'000	Total equity £'000
At 1 Jan 2020	260,000	69,000	88,708	417,708
Loss for the year	–	–	(27,285)	(27,285)
Distribution on other equity instrument	–	–	(5,003)	(5,003)
Net impact of equity-settled share-based payments	–	–	641	641
At 31 Dec 2020	260,000	69,000	57,061	386,061

Equity is wholly attributable to equity shareholders of Marks and Spencer Financial Services Plc.

Notes on the Financial Statements

1. Basis of preparation and significant accounting policies

1.1. Basis of preparation

(a) Compliance with International Financial Reporting Standards

The financial statements of the Entity have been prepared in accordance with UK adopted international accounting standards. There were no unendorsed standards effective for the year ended 31 December 2021 affecting these financial statements.

Standards adopted during the year ended 31 December 2021

There were no new accounting standards or interpretations that had a significant effect on the Entity in 2021. Accounting policies have been consistently applied.

(b) Future accounting developments

Minor amendments to IFRSs

The IASB has not published any minor amendments to IFRSs which are effective from 1 January 2021 that are applicable to the Entity. However, the IASB has published a number of minor amendments to IFRSs that are effective from 1 January 2022 and 1 January 2023. The Entity expects they will have an insignificant effect, when adopted, on the financial statements of the Entity.

New IFRSs

IFRS 17 'Insurance Contracts'

The IASB has published IFRS 17 'Insurance Contracts'. IFRS 17 has been endorsed for use in the EU but has not yet been endorsed for use in the UK. However, it is not expected to have a significant impact on the financial statements of the Entity.

(c) Presentation of information

The functional currency of the Entity is Sterling, which is also the presentational currency of the financial statements of the Entity.

Certain disclosures required by IFRSs have been included in the audited sections of this Annual Report and Financial Statements 2021 as follows:

- disclosures concerning the nature and extent of risks relating to financial instruments are included in the 'Management of Risk note' on page 42; and
- capital disclosures are included in the 'Report of the Directors: Capital Management' on Page 9.

The financial statements are prepared in accordance with the historical cost convention.

(d) Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items, highlighted as the 'critical accounting estimates and judgements' in section 1.2 below, it is possible that the outcomes in the next financial year could differ from those on which management's estimates are based. This could result in materially different estimates and judgements from those reached by management for the purposes of these financial statements. Management's selection of the Entity's accounting policies that contain critical estimates and judgements reflects the materiality of the items to which the policies are applied and the high degree of judgement and estimation uncertainty involved.

(e) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Entity have the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows, capital requirements and capital resources. These considerations include stressed scenarios that reflect the uncertainty that the global Covid-19 pandemic has had on the HSBC Group operations, as well as considering potential impacts from other top and emerging risks, and the related impact on profitability, capital and liquidity.

1.2. Summary of significant accounting policies

(a) Provisions, contingent liabilities and guarantees

Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation that has arisen as a result of past events and for which a reliable estimate can be made.

Critical accounting estimates and judgements

The recognition and measurement of provisions requires the Entity to make a number of judgements, assumptions and estimates. The most significant are set out below:

Judgements	*Estimates*
• Determining whether a present obligation exists. Professional advice is taken on the assessment of litigation, property (including onerous contracts) and similar obligations. • Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised, revising previous estimates as appropriate. At more advanced stages, it is typically easier to make estimates around a better defined set of possible outcomes.	• Provisions for legal proceedings and regulatory matters remain very sensitive to the assumptions used in the estimate. There could be a wider range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result it is often not practicable to quantify a range of possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved. • Provisions for customer remediation also require significant levels of estimation. The amounts of provisions recognised depend on a number of different assumptions, such as the volume of inbound complaints, the projected period of inbound complaint volumes, the decay rate of complaint volumes, the populations identified as systemically mis-sold and the number of policies per customer complaint. More information about these assumptions is included in Note 22.

Contingent liabilities, contractual commitments and guarantees

Contingent liabilities

Contingent liabilities related to legal proceedings or regulatory matters are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

As at 31 December 2021 the Entity did not hold any financial guarantee contracts (2020: nil).

(b) Income and expense

Interest income and expense

Interest income and expense for all financial instruments, excluding those classified as held for trading or designated at fair value are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method.

Interest on credit-impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Non-interest income and expense

Fee income is earned from a diverse range of services provided by the Entity to its customers. Fee income is accounted for as follows:

- Income earned on the execution of a performance obligation is recognised as revenue when the act is completed (for example, fees arising from sale of travel money); and
- Income earned from the provision of services is recognised as revenue as the services are provided (for example, interchange fee income).

Fee expense is recognised as services are received or liabilities are accrued.

Directly attributable acquisition costs are recognised over the estimated life of the relevant financial asset or financial liability. For credit cards this is 7 years. These are reviewed annually to ensure they remain appropriate.

Other operating income/expense

Profit share receivable/payable is recognised in accordance with the terms of the Relationship Agreement with M&S plc.

Gains/(losses) on financial instruments are calculated as the difference between the carrying amount of the loan pre-modification and the present value of estimated future cash flows, excluding credit losses, discounted at the loan's original effective interest rate. The Entity has applied this to the carrying value of financial instruments on which customer relief offers were available during the year.

(c) Financial instruments measured at amortised cost

Loans and advances

Financial assets that are held to collect the contractual cash flows and which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at amortised cost. Such financial assets include most loans and advances to banks and customers and some debt securities. In addition, most financial liabilities are measured at amortised cost. The carrying value of these financial assets at initial recognition includes any directly attributable transaction costs.

The Entity may commit to underwriting loans on fixed contractual terms for specified periods of time. When the Entity intends to hold the loan, a provision on the loan commitment is only recorded where it is probable that the Entity will incur a loss.

The effective interest rate ('EIR') applied to interest income recognised on credit card lending includes significant estimates and judgements related to their behavioural life. This life is estimated based on internal models and is reviewed regularly to reflect actual experience. The application of the effective interest rate method to credit card lending has resulted in the recognition of £59.6m (2020: £63.3m) within loans and advances to customers at 31 December 2021.

Judgements	Estimates
• The estimated life is reviewed annually and management has assessed seven years as continuing to be the most appropriate life. The impact of reducing the estimated life to six years would be a reduction in the EIR asset of £12.0m (2020: £11.4m). • A key metric is the stick rate, being the proportion of acquired balances which remain on book after the end of promotional period. Forecasts are refreshed on a periodic basis to adjust for a forward looking view and reflect latest actual trends.	Management has assessed the sensitivity of balance and interest assumptions by considering the impact of changes as follows: • a decrease in the closing balance stick rate assumption of 5% would decrease the asset value by £3.0m (2020:£3.2m); and • similarly, a decrease in the assumed interest yield of 5% would decrease the asset value by £6.7m (2020: £7.4m). (The interest yield assumption is the amount of interest receivable over the life of the account.)

(d) Impairment of amortised cost financial assets

ECL are recognised for loans and advances to banks and customers, non-trading reverse repurchase agreements, other financial assets held at amortised cost, debt instruments measured at FVOCI, and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of some loan commitments and financial guarantees) is required for ECL resulting from default events that are possible within the next 12 months or less, where the remaining life is less than 12 months ('12-month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets that are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit-impaired are in 'stage 3'.

Credit-impaired (stage 3)

The Entity determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay, such as when a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans that are considered defaulted or otherwise credit-impaired.

Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

Financial assets (and the related impairment allowances) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier. An estimation of future recovery is made at the date of the write-off and this balance is subsequently recognised as an asset.

Renegotiation

Loans are identified as renegotiated and classified as credit-impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit-impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument.

Other than originated credit-impaired loans, all other modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit-impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

Significant increase in credit risk (stage 2)

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared with that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower, and the geographical region. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending. Unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due.

For retail portfolios, default risk is assessed using a reporting date 12-month probability of default ('PD') derived from credit scores, which incorporates all available information about the customer. This PD is adjusted for the effect of macroeconomic forecasts for periods longer than 12 months and is considered to be a reasonable approximation of a lifetime PD measure. Retail exposures are first segmented into homogeneous portfolios, generally by country, product and brand. Within each portfolio, the stage 2 accounts are defined as accounts with an adjusted 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due. The expert credit risk judgement is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies loans with a PD higher than would be expected from loans that are performing as originally expected, and higher than what would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

Unimpaired and without significant increase in credit risk - (stage 1)

ECL resulting from default events that are possible within the next 12 months ('12-month ECL') are recognised for financial instruments that remain in stage 1.

Movement between stages

Financial assets can be transferred between the different categories depending on their relative increase in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated loans will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. For loans that are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances. For loans that are assessed for impairment on an individual basis, all available evidence is assessed on a case-by-case basis.

Measurement of ECL

The assessment of credit risk and the estimation of ECL are unbiased and probability-weighted, and incorporate all available information that is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money.

In general, the Entity calculates ECL using three main components: a probability of default, a loss given default ('LGD') and the exposure at default ('EAD').

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default, taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

The Entity leverages the Basel II IRB framework where possible, with recalibration to meet the differing IFRS 9 requirements set out in the following table:

Model	Regulatory capital	IFRS 9
PD	• Through the cycle (represents long-run average PD throughout a full economic cycle) • The definition of default includes a backstop of 90+ days past due, although this has been modified to 180+ days past due for some portfolios, particularly UK and US mortgages	• Point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD) • Default backstop of 90+ days past due for all portfolios
EAD	• Cannot be lower than current balance	• Amortisation captured for term products
LGD	• Downturn LGD (consistent losses expected to be suffered during a severe but plausible economic downturn) • Regulatory floors may apply to mitigate risk of underestimating downturn LGD due to lack of historical data • Discounted using cost of capital • All collection costs included	• Expected LGD (based on estimate of loss given default including the expected impact of future economic conditions such as changes in value of collateral) • No floors • Discounted using the original effective interest rate of the loan • Only costs associated with obtaining/selling collateral included
Other		• Discounted back from point of default to balance sheet date

While 12-month PDs are recalibrated from Basel II models where possible, the lifetime PDs are determined by projecting the 12-month PD using a term structure.

Period over which ECL is measured

ECL is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the Entity is exposed to credit risk. The date of the substantive credit review also represents the initial recognition of the new facility. However, where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit the Entity's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the Entity remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to retail overdrafts and credit cards, where the period is the average time taken for stage 2 exposures to default or close as performing accounts, determined on a portfolio basis and ranging from between two and six years. In addition, for these facilities it is not possible to identify the ECL on the loan commitment component separately from the financial asset component. As a result, the total ECL is recognised in the loss allowance for the financial asset unless the total ECL exceeds the gross carrying amount of the financial asset, in which case the ECL is recognised as a provision.

Forward-looking economic inputs

The Entity follows a HSBC group wide methodology. The group applies multiple forward-looking global economic scenarios determined with reference to external forecast distributions representative of our view of forecast economic conditions. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. In certain economic environments, additional analysis may be necessary and may result in additional scenarios or adjustments, to reflect a range of possible economic outcomes sufficient for an unbiased estimate.

Critical accounting estimates and judgements

The calculation of the Entity's ECL under IFRS 9 requires the to make a number of judgements, assumptions and estimates. The most significant are set out below:

Judgements	Estimates
• Defining what is considered to be a significant increase in credit risk. • Determining the lifetime and point of initial recognition of overdrafts and credit cards. • Selecting and calibrating the PD, LGD and EAD models, which support the calculations, including making reasonable and supportable judgements about how models react to current and future economic conditions. • Selecting model inputs and economic forecasts, including determining whether sufficient and appropriately weighted economic forecasts are incorporated to calculate unbiased expected loss. • Making management judgemental adjustments to account for late breaking events, model and data limitations and deficiencies, and expert credit judgements.	• The measurement uncertainty and sensitivity analysis of ECL estimates on page 44 set out the assumptions used in determining ECL and provide an indication of the sensitivity of the result to the application of different weightings being applied to different economic assumptions.

(e) Employee compensation and benefits

Share-based payments

The Entity enters into equity-settled UK Sharesave Plan Options payment arrangements with its employees as compensation for the provision of their services.

The vesting period for these schemes may commence before the legal grant date if the employees have started to render services in respect of the award before the legal grant date, where there is a shared understanding of the terms and conditions of the arrangement. Expenses are recognised when the employee starts to render service to which the award relates.

Cancellations result from the failure to meet a non-vesting condition during the vesting period, and are treated as an acceleration of vesting recognised immediately in the income statement. Failure to meet a vesting condition by the employee is not treated as a cancellation, and the amount of expense recognised for the award is adjusted to reflect the number of awards expected to vest.

Post-employment benefit plans

The HSBC group operates pension schemes including defined benefit, defined contribution, and post-employment benefit schemes. Further details regarding these schemes are set out in Note 5.

Payments to defined contribution schemes are charged as an expense as the employees render service.

(f) Tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case the tax is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year and on any adjustment to tax payable in respect of previous years. The Entity provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet, and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax is calculated using the tax rates expected to apply in the periods as the assets will be realised or the liabilities settled.

Current and deferred tax are calculated based on tax rates and laws enacted, or substantively enacted, by the balance sheet date.

(g) Items in the course of collection from other banks

The Entity recognises items in the course of collection from other banks when funds in respect of customer payments are still to be received from other institutions.

(h) Right-of-use assets

In line with the requirements of IFRS16 the Entity recognises Right-of-use ('ROU') assets where leases in respect of its office and branch locations have been entered into.

Leases are recognised as an ROU asset and a corresponding liability at the date at which the leased asset is made available for use with measurement based on the present value of future cash flows over the term of the lease. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit and loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability. The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis.

(i) Property, plant and equipment

Equipment, fixtures and fittings are stated at cost less impairment losses and depreciation over their useful lives, which are generally between 2 years and 5 years. Property, plant and equipment is subject to an impairment review if their carrying amount may not be recoverable.

(j) Intangible assets

Intangible assets are stated at cost less amortisation and are amortised straight line over their estimated useful lives of 5 years. Expenditure on internally developed software is recognised as an asset when the Entity is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits and can reliably measure the cost to complete development. Borrowing costs are not included in the capitalised costs of intangible assets. Assets are subject to regular impairment reviews which compare the carrying value to the expected value in use. Any impairment losses are recognised in the Income Statement. Amortisation does not commence until the asset is brought into operational use.

(k) Other assets

Other assets include profit share recoverable from M&S plc. Under the terms of the Relationship Agreement ('RA') with M&S plc, profits and losses of the Entity are shared equally, after adjustments for capital and funding costs. When the Entity is profitable this results in profit share payable to M&S plc, with settlement on a quarterly basis after the recoverability of any profit share owed by M&S. In years when the Entity is loss-making, as in 2019 and 2020, there is profit share recoverable from M&S plc. This is recognised as a non-financial asset and recovered through offset of future profit share and other fees payable under the RA as in 2021. The asset is recognised on the balance sheet at cost and in line with the requirements of IAS 36 Impairment of Assets an impairment assessment is performed.

(l) Deposits by banks

Liabilities in respect of borrowings from HSBC UK are recognised within deposits by banks. Deposits by banks are recognised at amortised cost.

(m) Customer accounts

The Entity recognises within customer accounts liabilities for savings deposits received from customers and credit balances which have arisen in respect of unsecured lending products. Customer accounts are measured at amortised cost.

(n) Accruals, deferred income and other liabilities

The Entity recognises liabilities to other group companies in respect of outstanding recharges of costs and settlement of cash transfers. Income in respect of certain products is deferred and recognised over the life of the product where payment has already been made by the customer, for example, credit card balance transfer fees. The lease liability in respect of ROU assets is included within other liabilities.

(o) Subordinated liabilities

The Entity recognises subordinated loans from other group entities within subordinated liabilities. Subordinated liabilities are recognised at amortised cost.

(p) Called up share capital

Financial instruments issued are generally classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax. Share capital for the Entity consists of ordinary shares, issued and fully paid.

(q) Cash and balances at central banks

Cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition.

2. Operating Profit/(loss)

Operating Profit/(loss) is stated after the following items:

	2021 £'000	2020 £'000
Interest income		
Loans and advances to customers	**180,012**	191,549
Interest received from group undertakings	**1,596**	6,201
Total interest income	**181,608**	197,750
Interest expense		
Customer accounts	**3,987**	7,590
Interest paid to group undertakings	**13,958**	24,443
Other interest paid	**217**	499
Total interest expense	**18,162**	32,532
Fee and commission income		
Product fee income	**48,832**	43,510
Insurance income	**17,597**	15,475
Other income	**3,571**	5,222
Total fee and commission income	**70,000**	64,207
Fee and commission expense		
Product acquisition and retention costs	**9,584**	18,643
Other fees paid	**16,298**	9,266
Total fee and commission expense	**25,882**	27,909
Change in expected credit losses and other credit impairment charges		
Change in expected credit losses and other credit impairment charges	**(97,747)**	155,851
Total change in expected credit losses and other credit impairment charges	**(97,747)**	155,851
General and administrative expenses		
Remediation costs	**9,524**	(16,081)
Expenses payable to group undertakings	**44,201**	42,188
Other expenses	**39,609**	39,620
Total general and administrative expenses	**93,334**	65,727

3. Other operating income

	2021 £'000	2020 £'000
Sublease rental income	**71**	426
Gains/(losses) on Financial Instruments	**456**	(911)
M&S plc profit share	**–**	33,816
Total other operating income	**527**	33,331

4. Other operating expense

	2021 £'000	2020 £'000
M&S plc profit share	**47,828**	–
Fees incurred as a result of re-issuance of AT1 capital	**458**	–
Other	**85**	–
Total other operating expenses	**48,371**	–

M&S plc Profit Share is an expense in the year (2020: income) due to improved business performance.

5. Employee compensation and benefits

Total employee compensation

	2021 £'000	2020 £'000
Wages and salaries including share-based payments	**35,773**	35,928
Social security costs	**3,125**	3,169
Post-employment benefits	**4,602**	5,384
Year ended 31 Dec	**43,500**	44,481

Employee compensation is paid by HSBC and recharged to the Entity.

Average number of persons employed by the Entity during the year

	2021	2020
Head Office Administration	**574**	572
Selling and Distribution	**537**	766
Year ended 31 Dec	**1,111**	1,338

Post employment benefit plans

The principal plan

The Entity's employees are either members of Defined Contribution ('DC') schemes solely or members of DC and Defined Benefit ('DB') schemes.

The defined benefit section was closed to future benefit accrual in 2015, with defined benefits earned by employees at that date continuing to be linked to their salary while they remain employed by HSBC UK. The plan is overseen by an independent corporate trustee, who has a fiduciary responsibility for the operation of the plan. Its assets are held separately from the assets of the group.

There is no contractual agreement or stated policy for charging the net defined benefit cost from HSBC UK to the other members of the group pension plan. Instead the Entity makes a regular payment to HSBC UK, for HSBC UK to invest in the various schemes on behalf of the Entity's employees. The Entity would not contribute to any scheme deficit, except through amendments to its regular payments. Full disclosure of the principal actuarial financial assumptions used to calculate the defined benefit pension plans at 31 December 2021, of which employees of the Entity are members, are disclosed in the statutory accounts of HSBC UK.

6. Share-based payments

The share-based payment income statement charge is recognised in wages and salaries as follows:

	2021 £'000	2020 £'000
Savings-related and other share award option plans	**669**	638
Year ended 31 Dec	**669**	638

HSBC share option plans

Plans	Policy
Savings-related share option plans ('Sharesave')	• Eligible employees can save up to £500 per month with the option to use the savings to acquire shares. • Exercisable within six months following either the third or fifth anniversary of the commencement of a three-year or five year contract, respectively. • The exercise price is set at a 20% (2020: 20%) discount to the market value immediately preceding the date of invitation.

Calculation of fair values

The fair values of share options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

Movement on HSBC share option plans

	Savings-related share options	
	Number	**WAEP[1] £**
Outstanding at 1 Jan 2021	**1,224**	**5.11**
Granted during the year	**372**	**3.15**
Exercised during the year	**(189)**	**5.39**
Expired during the year	**(272)**	**3.81**
Outstanding at 31 Dec 2021	**1,135**	**5.21**
Weighted average remaining contractual life (years)		**2**

	Savings-related share options	
	Number	WAEP[1] £
Outstanding at 1 Jan 2020	1,312	5.74
Granted during the year	669	2.63
Exercised during the year	(246)	2.77
Expired during the year	(511)	5.02
Outstanding at 31 Dec 2020	1,224	5.11
Weighted average remaining contractual life (years)		2

1 *The weighted average exercise price (WAEP) of share options outstanding, which is calculated when transactions are contracted, was £3.96 (2020: £4.55).*

7. Directors' emoluments

The aggregate emoluments of the Directors of the Entity, computed in accordance with the Companies Act 2006 as amended by statutory instrument 2008 No. 410, were:

	2021	2020
	£'000	£'000
Fees [1]	90	133
Salaries and other emoluments [2]	387	408
Pension contributions	25	35
Annual incentives [3]	99	147
Year ended 31 Dec	**601**	723

1 *Fees include fees paid to non-executive Directors.*

2 *Salaries and other emoluments include fixed pay allowance. No remuneration is disclosed for Directors who are employed by other companies within the HSBC Group and their services are incidental to their other responsibilities within the HSBC Group.*

3 *Awards made to executive Directors in respect of 2021 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £33,000 in cash, £14,400 in deferred cash (vesting annually over a three year period), £33,000 in immediate shares and £18,000 in deferred shares (vesting annually over a three year period) issued under the HSBC Share Plan.*

Awards made to executive Directors in respect of 2020 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £136,800 in cash, nil in deferred cash (vesting annually over a three year period),nil in immediate shares and £9,900 in deferred shares (vesting annually over a three year period) issued under the HSBC Share Plan.

No Directors exercised share options over HSBC Holdings plc ordinary shares during the year (2020: nil).

Awards were made to two Directors under long-term incentive plans in respect of qualifying services rendered in 2021 (2020: two Directors). During 2021, two Directors received shares in respect of awards under long-term incentive plans that vested during the year (2020: two).

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the Entity's ultimate parent company, HSBC Holdings plc. The cost of any conditional awards under the HSBC Share Plan and the HSBC Plan 2011 ('the Plans') is recognised through an annual charge based on the fair value of the awards, apportioned over the period of service to which the award relates. Details of the Plans are contained within the Directors' Remuneration Report of HSBC Holdings plc.

Of these aggregate figures, the following amounts are attributable to the highest paid Director:

	2021	2020
	£'000	£'000
Salaries and other emoluments	246	245
Annual incentives [1]	68	95
Year ended 31 Dec	**314**	340

1 *Awards made to the highest paid Director in respect of 2021 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £21,600 in cash, £11,700 in deferred cash (vesting annually over a three year period), £21,600 in immediate shares and £13,500 in deferred shares (vesting annually over a three year period) issued under the HSBC Share Plan. Awards made to the highest paid Director in respect of 2020 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £85,500 in cash, nil in deferred cash (vesting annually over a three year period), nil in immediate shares and £9,900 in deferred shares (vesting annually over a three year period) issued under the HSBC Share Plan.*

The highest paid Director received 3,273 (2020: 9,277) shares, in respect of qualifying services, as the result of awards under long-term incentive plans that vested during the year. The highest paid Director exercised no (2020: none) share options over HSBC Holdings plc ordinary shares during the year.

Pension contributions of £3,600 (2020: £5,400) were made by the Entity in respect of services by the highest paid Director during the year.

8. Auditors' remuneration

	2021	2020
	£'000	£'000
Audit fees for statutory audit		
- Fees relating to current year	540	479
- Other audit-related services pursuant to regulation	45	34
- Other services	—	7
Year ended 31 Dec	**585**	520

Certain elements of audit work are performed centrally across the HSBC Group. These items are not recharged to the Entity.

9. Tax credit/(expense)

Tax expense

	2021 £'000	2020 £'000
Current tax		
UK corporation tax		
- For this year	**24,573**	(10,794)
- Adjustments in respect of prior years	**(2,026)**	2,093
Total current tax	**22,547**	(8,701)
Deferred tax		
- For this year	**1,401**	1,760
- Effects of changes in tax rates	**(2,175)**	(1,029)
- Adjustments in respect of prior years	**460**	(404)
Total deferred tax	**(314)**	327
Year ended 31 Dec	**22,233**	(8,374)
Equity items		
- Current tax	**5**	4
- Deferred tax - current year	**(248)**	(7)
- Deferred tax - prior year	**(14)**	–
Total equity items	**(257)**	(3)

The UK corporation tax rate applying to the Entity was 27%, comprising 19% UK corporation tax plus 8% surcharge tax rate on UK banking profits (2020: 27%).

In addition to the amount charged to the income statement, the aggregate amount of current and deferred tax relating to items that are credited directly to equity is £257k.

Tax reconciliation

The tax charged to the income statement differs from the tax expense that would apply if all profits had been taxed at the UK corporation tax rate as follows:

	2021 £'000	2021 (%)	2020 £'000	2020 (%)
Profit/(loss) before tax	**115,795**		(35,659)	
Tax at 19% (2019: 19%)	**22,001**	**19.00**	(6,775)	19.00
Adjustments in respect of prior years	**(1,566)**	**(1.35)**	1,690	(4.74)
Permanent disallowables	**(3,939)**	**(3.40)**	1,944	(5.45)
Impact due to changes in tax rates	**(2,175)**	**(1.88)**	(1,029)	2.88
Deductions for AT1 coupon payments	**(1,351)**	**(1.17)**	(1,351)	3.79
Banking surcharge	**9,263**	**8.00**	(2,853)	8.00
Year ended 31 Dec profit/(loss)	**22,233**	**19.20**	(8,374)	23.48

The effective tax rate for the year was 19.2% (2020: 23.5%). This is lower than the UK rate of corporation tax for banking entities of 27% (2020: 27%), with the largest adjusting item being a credit of £3,939k (2020: £1,944k charge) mostly due to the release of redress provisions and a further credit of £2,175k (2020: £1,029k) from the remeasurement of deferred tax balances following enactment of legislation to increase the main rate of UK corporation tax from 19% to 25% from 1 April 2023.

In the Budget on 27 October 2021 HM Treasury announced that the banking surcharge rate will decrease from 8% to 3% with effect from 1 April 2023. This has not been reflected for accounting purposes since legislation to effect this change was not substantively enacted at the balance sheet date.

10. Deferred tax assets

	Property, plant and equipment £'000	Share based payments £'000	Other temporary differences £'000	IFRS 9 Transitional Adjustments £'000	Total £'000
At 1 Jan 2021	**4,180**	**51**	**431**	**7,545**	**12,207**
Income statement credit/(charge)	**333**	**65**	**18**	**358**	**774**
Equity statement credit	**–**	**249**	**–**	**–**	**249**
Prior year adjustments	**(93)**	**(14)**	**(347)**	**(20)**	**(474)**
At 31 Dec 2021	**4,420**	**351**	**102**	**7,883**	**12,756**

	Property, plant and equipment	Share based payments	Other temporary differences	IFRS 9 Transitional Adjustments	Total
	£'000	£'000	£'000	£'000	£'000
At 1 Jan 2020	4,461	84	–	7,983	12,528
Income statement (charge)/credit	(285)	(40)	32	(438)	(731)
Equity statement expense	–	7	–	–	7
Prior year adjustments	4	–	399	–	403
At 31 Dec 2020	4,180	51	431	7,545	12,207

Management has assessed the likely availability of future taxable profits against which to recover the deferred tax assets of the Entity and the HSBC Group, taking into consideration the reversal of existing taxable temporary differences, past business performance and forecasts of future business performance. Management is satisfied that there is sufficient evidence to support recognition of all deferred tax assets.

11. Reconciliation of profit/(loss) before tax to net cash flow from operating activities

	2021	2020
	£'000	£'000
Profit/(loss) before tax	**115,795**	(35,659)
Non-cash items included in profit and loss		
Depreciation, amortisation and impairment	**4,835**	4,447
Credit-related impairment losses	**(140,189)**	112,246
Decrease in provisions	**(39,671)**	(103,145)
	(175,025)	13,548
Change in operating assets		
Change in prepayments and accrued income	**(472)**	986
Change in loans and advances to customers[1]	**231,374**	787,042
Change in other assets	**67,522**	(34,307)
Change in Loans and advances to banks	**366,000**	(440,000)
	664,424	313,721
Change in operating liabilities		
Change in accruals and deferred income	**1,610**	(3,668)
Change in customer accounts[2]	**(1,093,157)**	55,275
Change in other liabilities	**9,134**	(29,201)
	(1,082,413)	22,406
Cash and cash equivalents comprise		
Cash and balances at central banks[3]	**5,013**	10,365
Items in the course of collection from other banks	**9,028**	9,267
Loans and advances to banks of one month or less	**599,546**	938,658
Deposit by banks of one month or less	**(145,000)**	(155,000)
Less: Items in the course of transmission to other banks	**(1,599)**	(3,275)
	466,988	800,015

1. *Operating assets movement includes of £231m change in Loans and advances to customers and £366m change in Loans and advances to banks (discontinued operations).*
2. *Operating liabilities movement includes £722m Current Account balance, £48m Monthly Saver balance and £208m Everyday Saver balance (discontinued operations).*
3. *At 31 December 2021 £4.3m (2020: £4.1m) was not available for use by the Entity as it relates to mandatory deposits at central banks.*

12. Fair value of financial instruments not carried at fair value

Where repricing is greater than six months using discounted cash flow, each loan or deposit is valued using a relevant market rate based discount curve applied to the expected cash flows.

Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

		Fair values			
			Valuation techniques		
	Carrying amount	Quoted price	Using observable inputs	With significant unobservable inputs	Total
		Level 1	Level 2	Level 3	
	£'000	£'000	£'000	£'000	£'000
At 31 Dec 2021					
Assets					
Loans and advances to banks	**908,547**	**–**	**908,547**	**–**	**908,547**
Loans and advances to customers	**3,147,992**	**–**	**–**	**3,147,992**	**3,147,992**
Liabilities					
Deposits by banks	**2,400,000**	**–**	**2,400,000**	**–**	**2,400,000**
Customer accounts	**1,085,433**	**–**	**1,085,433**	**–**	**1,085,433**
Subordinated liabilities	**96,367**	**–**	**95,967**	**–**	**95,967**
At 31 Dec 2020					
Assets					
Loans and advances to banks	1,613,658	–	1,613,658	–	1,613,658
Loans and advances to customers	3,239,177	–	–	3,239,177	3,239,177
Liabilities					
Deposits by banks	2,260,034	–	2,260,034	–	2,260,034
Customer accounts	2,178,589	–	2,178,589	–	2,178,589
Subordinated liabilities	95,164	–	95,164	–	95,164

Valuation

Fair value is an estimate of the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the Entity expects to flow from an instrument's cash flow over its expected future life. The Entity's valuation methodologies and assumptions in determining fair values for which no observable market price are available may differ from those of other companies.

Loans and advances to banks and customers

The carrying amount of loans and advances is deemed a reasonable approximation of fair value, given the related maturity and interest rate on the instruments.

Deposits by banks and customer accounts

The carrying amount of deposits by banks and customer accounts are deemed a reasonable approximation of fair value, given the related maturity and interest rate on the instruments.

Subordinated liabilities

Fair values are determined using quoted market prices at the balance sheet date where available, or by reference to quoted market prices for similar instruments. When quoted market prices are unavailable, these instruments are valued using valuation techniques, the inputs for which are derived from observable market data and, where relevant, assumptions in respect of unobservable inputs.

Other financial instruments not carried at fair value are typically short-term in nature and reprice to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value. They include cash and balances at central banks and items in the course of collection from and transmission to other banks, all of which are measured at amortised cost.

13. Discontinued operations

As part of a business transformation programme, the mortgage portfolio was transferred to HSBC UK in June 2021 at no gain or loss. The current account product, linked savings product and branch network were closed in the second half of the year.

Income Statement

	2021 £'000	2020 £'000
Interest income	6,187	14,397
Interest expense	(2,002)	(4,867)
Net interest income	4,185	9,530
Fee and commission income	823	1,334
Fee and commission expense	(9,313)	(6,252)
Net fee income	(8,490)	(4,918)
Other operating income	3,340	5,576
Net operating income before change in expected credit losses and other credit impairment charges	(965)	10,188
Change in expected credit losses and other credit impairment charges	650	(746)
Net operating income	(315)	9,442
Employee compensation and benefits	(5,791)	(13,754)
General and administrative expenses	(1,983)	(4,314)
Total operating expenses	(7,774)	(18,068)
Operating profit	(8,089)	(8,626)
Profit before tax	(8,089)	(8,626)
Tax credit	1,553	2,024
Profit/ (Loss) for the year	(6,536)	(6,602)

Cash flows relating to the discontinued operations are shown in the table below:

Cash Flow Statement

	2021 £'000	2020 £'000
Cash flows from operating assets	227,525	12,710
Cash flows from operating liabilities	(769,900)	155,250
Cash flows from loans and advances to banks[1]	769,900	(155,250)
Cash flows from cash and cash equivalents	(227,525)	(12,710)
Net cash flows for the year	—	—

1 *Cash flows from loans and advances to banks is included in cash flows from operating assets in the Cash flow statement.*

Includes mortgages, current account and monthly saver balances and the borrowings/deposits attributed to those products. Operating assets and liabilities are funded through borrowings and deposits with HSBC UK. The movement in customer balances is offset by changes in group funding levels.

14. Loans and advances to banks

	2021 £'000	2020 £'000
Loans and advances held with parent	908,407	1,612,879
Nostro balances with parent and fellow subsidiaries	140	779
At 31 Dec	908,547	1,613,658

Amounts due from group undertakings are unsecured, interest bearing and have fixed dates of repayment which range from 19 January 2022 to 17 January 2024. All loans and advances to other banks have variable interest rates and are repayable on demand.

Nostro balances are variable rate and totalled £0.1m.

15. Loans and advances to customers

	2021 £'000	2020 £'000
Gross loans and advances to customers	3,248,247	3,479,622
Expected credit loss provision (Note 28)	(100,255)	(240,445)
At 31 Dec	3,147,992	3,239,177

Loans and advances to customers by product

	2021		2020	
	Gross loans and advances to customers	**Gross loan by product as % of total gross loans**	Gross loans and advances to customers	Gross loan by product as % of total gross loans
	£'000	**%**	£'000	%
Residential mortgages	**—**	**— %**	228,938	7 %
Cards	**2,052,901**	**63 %**	2,053,557	59 %
Consumer Loans	**1,184,152**	**36 %**	1,182,349	34 %
Other Personal	**11,194**	**— %**	14,778	— %
At 31 Dec	**3,248,247**	**100 %**	3,479,622	100 %
Impaired loans	**64,649**		72,437	
as a % of total	**2.0**		2.1	

The measurement of loans and advances to customers at amortised cost requires management to estimate the EIR for Credit Card and results in the build-up of an asset during promotional periods as interest is accrued but not earned. This has resulted in the recognition of £59.6m within loans and advances to customers as at 31 December 2021 (31 December 2020: £63.0m).

The effective interest rate approach incorporates a number of key assumptions as follows:

- the estimated life of the customer account (currently 7 years);
- future balance forecasts; and
- future interest forecasts.

The estimated life is reviewed annually and the Entity has assessed 7 years as continuing to be the most appropriate life (2020: 7 years).

Future balance and interest forecasts are initially established using internal pricing models and are reviewed regularly to reflect actual experience. A key metric is the proportion of acquired accounts which remain active after the end of promotional period. Where these proportions differ from forecast in relation to balance and interest an adjustment to the carrying value of the asset must be recognised in the financial statements.

Management have assessed the sensitivity of balance and interest assumptions by considering the impact of changes to these on significant offer plans.

In the case of front book plans (31 December 2021 asset value: £49.8m), a 5% decrease in the balance of the proportion of acquired accounts which remain active at the end of the promotional period would decrease the asset value by £2.5m. A 5% decrease in the assumed interest yield would decrease the asset value by £5.8m.

In the case of back book plans (31 December 2021 asset value: £9.8m), a 5% decrease in the balance of the proportion of acquired accounts which remain active at the end of the promotional period would decrease the asset value by £0.5m. A 5% decrease in the assumed interest yield would decrease the asset value by £0.9m.

Conversely, increases in the above assumptions would increase asset values by similar amounts.

The estimated life is reviewed annually and management has assessed seven years as continuing to be the most appropriate life. The impact of reducing the estimated life to six years would be a reduction in EIR asset of £12.0m (2020 £11.4m).

16. Property, plant and equipment

	Equipment, fixtures and fittings	
	2021	2020
	£'000	£'000
Cost		
At 1 Jan	**51,312**	50,749
Additions	**176**	563
As at 31 Dec	**51,488**	51,312
Accumulated depreciation		
At 1 Jan	**49,832**	49,203
Charge for the year	**977**	629
As at 31 Dec	**50,809**	49,832
Net book value		
At 1 Jan	**1,480**	1,546
As at 31 Dec	**679**	1,480

17. Intangible assets

	Software development costs 2021 £'000	Software development costs 2020 £'000
Cost		
At 1 Jan	**56,650**	56,131
Additions	**3,443**	—
Adjustment	**—**	519
As at 31 Dec	**60,093**	56,650
Accumulated amortisation		
At 1 Jan	**55,643**	54,640
Charge for the year	**791**	529
Adjustment	**—**	474
As at 31 Dec	**56,434**	55,643
Net book value		
At 1 Jan	**1,007**	1,491
As at 31 Dec	**3,659**	1,007

18. Other assets

	2021 £'000	2020 £'000
Amounts due from group undertakings	**18,570**	34,654
Profit Share due from M&S plc	**70,551**	120,378
Other items due from M&S plc	**6,916**	5,882
Other assets	**6,352**	8,996
At 31 Dec	**102,389**	169,910

Amounts due from group undertakings are unsecured and repayable on demand.

Profit share due from M&S plc will be recovered in line with the relationship agreement, through offsetting future profit share charges as profits are earned. In line with the requirements of IAS 36, an impairment assessment has been performed to account for potential variability in future cash flows required to recover the balance.

The impairment assessment considers the recoverability of the asset with recovery dependent upon future profits of the Entity's business which are forecast within the Financial Resources Plan of the Entity over the period 2022-2026. This indicates that there is no impairment requirement.

19. Deposits by banks

	2021 £'000	2020 £'000
Amounts due from group undertakings	**2,400,000**	2,260,034
At 31 Dec	**2,400,000**	2,260,034

Amounts due to group undertakings are unsecured, interest bearing, and have fixed dates of repayment which range from 19 January 2022 to 11 November 2026.

20. Customer accounts

	2021 £'000	2020 £'000
Credit balances on unsecured loans and advances	**10,672**	12,473
Customer deposits	**1,074,761**	2,166,116
At 31 Dec	**1,085,433**	2,178,589

Customer savings deposits have both fixed and variable interest rates and are repayable on demand. Customer deposits with variable rates totalled £747m (2020: £1,797m). Customer deposits with fixed rates totalled £327m (2020: £370m).

21. Accruals, deferred income and other liabilities

	2021 £'000	2020 £'000
Accruals and deferred income	**16,221**	14,610
Amounts owed to intermediate parent undertaking	**2,955**	2,217
Amounts owed to other group companies	**11,580**	13,820
Items in the course of settlement	**33,096**	20,227
Lease liabilities	**12,540**	17,116
Other liabilities	**5,111**	4,639
At 31 Dec	**81,503**	72,629

Amounts repayable to group companies and the immediate parent are unsecured, interest free and have no fixed date of repayments. Details for the leases entered into are set out in note 27.

22. Provisions

	Restructuring provision £'000	Skilled person review provision £'000	NOSIA provision £'000	Customer redress provision £'000	Fraud provision £'000	ECL on undrawn commitments £'000	Total £'000
At 1 Jan 2021	**1,054**	**36,756**	**233**	**49,802**	**444**	**4,072**	**92,361**
Increase/(Decrease) in provision	**4,298**	**3,960**		**12,220**		**(2,571)**	**17,907**
Provision utilised	**(2,245)**	**(21,657)**	**(125)**	**(21,731)**	**–**	**–**	**(45,758)**
Provision released	**(1,870)**	**(8,615)**		**(1,335)**	**–**	**–**	**(11,820)**
At 31 Dec 2021	**1,237**	**10,444**	**108**	**38,956**	**444**	**1,501**	**52,690**
At 1 Jan 2020	2,183	15,192	246	176,803	444	639	195,507
Increase/(Decrease) in provision	955	21,564	–	(18,374)	–	3,433	7,578
Provision utilised	(1,867)	–	(13)	(108,627)	–	–	(110,507)
Provision released	(217)	–	–	–	–	–	(217)
At 31 Dec 2020	1,054	36,756	233	49,802	444	4,072	92,361

Restructuring provision

A provision of £1.2m (2020: £1.1m) exists for redundancy payments to a number of employees where employment is to be terminated as part of a restructuring programme. The provision reflects the full amount of payments agreed with the individuals affected.

Customer redress - Collections and recoveries related matters (skilled persons review)

At 31 December 2021, a provision of £10m (2020: £37m) was held, being the estimated liability for redress payable to customers following a review of historical collections and recoveries practices in HSBC UK, including the Entity.

The provision has been calculated based on a number of customer cohorts who have been impacted and the operational costs of the programme. While most of these customers have now been fully evaluated and remediated, there remain a number of judgemental assumptions within the provision. The provision has been adjusted to reflect the latest available information, and as a result, the provision has decreased by a net £5m to take account of these factors and the impact on the operational costs.

The majority of payments have now been issued in relation to customers in those cohorts within which redress assessment has been completed, and this is expected to be completed during 2022. Work to complete the evaluation of the programme and finalise relevant data continues, and there is significant judgment applied surrounding the amount of any remaining redress to be issued and the assumed take-up rate of payments by customers. Where judgmental assumptions to calculate the required provision continue to be applied, a 20% increase/decrease in the level of redress to be paid in respect of fees and charges would lead to a £1m increase/decrease in total redress payable.

Customer redress - PPI

At 31 December 2021, £39m (2019: £50m) of the customer remediation provision relates to the estimated liability for redress in respect of the possible mis-selling of payment protection insurance ('PPI') policies in previous years. Of the £50m balance at 31 December 2020, £22m has been utilised during 2021.

An net increase in provisions of £11m was recognised during the year, primarily reflecting higher than expected costs associated with handling of court claims, offset by lower than expected litigation volumes received.

The estimated liability for PPI consists of the following components:

a. Claims yet to be resolved and paid, predominantly those pursued via litigation. Future estimated volumes and redress levels are based on historically observed volumes and redress paid to customers per claim; and

b. Operating expenses relating to claims yet to be worked, and with programme closure.

The PPI provision remains sensitive to changes in assumptions and estimates relating to the profile of litigation claims yet to be assessed, and to changes in recent experience. This could lead to future litigation volumes, uphold and payment rates, and costs per claim being observed which differ from those included in arriving at the provision.

a. A 20% increase/decrease in the uphold rate and average redress for litigation yet to be worked would increase/decrease the redress provision by approximately £5m.

b. A 20% increase/decrease in the volume of future claims received via litigation would increase/decrease the redress provision by approximately £5m.

c. A 20% increase/decrease in handling cost per court claim would increase/decrease the redress provision by approximately £4m.

ECL on undrawn commitments

Further disclosure on 'ECL on undrawn commitments' can be found in the Credit Risk section of Note 28.

23. Subordinated liabilities

	2021 £'000	2020 £'000
£54m floating rate loan maturing 2026	–	54,127
£25m variable/fixed rate notes maturing 2027	–	25,032
£9m variable/fixed rate notes maturing June 2029 [1]	**9,002**	9,002
£7m variable/fixed rate notes maturing December 2029 [2]	**7,004**	7,003
£79m fixed rate notes maturing March 2031 [3]	**80,361**	–
At 31 Dec	**96,367**	95,164

The subordinated loans above are presented on an IFRS accounting basis at amortised cost plus accrued interest. The loans rank behind senior obligations and qualify for inclusion within the Entity's tier 2 capital resources (loan value only).

On the 11th March 2021 the Entity exercised the issuer call option at the first call date on the £54m loan maturing 2026, and early redeemed the £25m loan maturing 2027 (both in issuance to HSBC UK Holdings Ltd). The instruments were replaced with a single CRR2 compliant subordinated loan of £79m issued to HSBC UK Bank plc maturing March 2031. The Entity has not had any defaults of principal or interest or other breaches with respect to its subordinated liabilities during the years ended 31 December 2021 and 2020.

On the 21st October 2021 the reference rates for the £9m and £7m variable rate subordinated liabilities were transitioned from LIBOR to SONIA via an amendment agreement. An applicable spread to represent the point in time difference between LIBOR and SONIA was added to the terms of each instrument.

[1] *Lender is HSBC UK Bank plc. The interest rate is SONIA T-5 basis + 212 bps + 10.4 bps.*

[2] *Lender is HSBC UK Bank plc. The interest rate is SONIA T-5 basis + 163 bps +10.69 bps.*

[3] *Lender is HSBC UK Bank plc. The interest rate is Fixed at 2.125%.*

24. Maturity analysis of assets and liabilities

The following is an analysis of assets and liabilities by residual contractual maturities at the balance sheet date.

	On demand	Due within 3 months	Due between 3 - 12 months	Due between 1 - 5 years	Due after 5 years	Undated	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets							
Cash and balances with central banks	5,013	–	–	–	–	–	5,013
Items in the course of collection from other banks	9,028	–	–	–	–	–	9,028
Loans and advances to banks	44,547	610,000	110,000	65,000	79,000	–	908,547
Loans and advances to customers	7,309	2,099,434	289,921	724,212	27,116	–	3,147,992
Prepayments and accrued income	–	3,343	–	–	–	–	3,343
Other assets	–	31,839	–	–	–	70,550	102,389
Right-of-use assets	–	–	–	–	12,175	–	12,175
Non-financial assets	–	–	–	–	–	17,094	17,094
At 31 Dec 2021	65,897	2,744,616	399,921	789,212	118,291	87,644	4,205,581
Liabilities							
Deposits by banks	–	440,000	690,000	1,270,000	–	–	2,400,000
Customer accounts	1,085,433	–	–	–	–	–	1,085,433
Items in the course of transmission to other banks	1,599	–	–	–	–	–	1,599
Accruals and other financial liabilities	–	506	1,534	6,702	3,798	68,963	81,503
Subordinated liabilities	–	1,367	–	–	95,000	–	96,367
Provisions	–	10,661	21,189	20,840	–	–	52,690
Non-financial liabilities	–	12,470	–	–	–	–	12,470
At 31 Dec 2021	1,087,032	465,004	712,723	1,297,542	98,798	68,963	3,730,062

	On demand	Due within 3 months	Due between 3 - 12 months	Due between 1 - 5 years	Due after 5 years	Undated	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets							
Cash and balances with central banks	10,365	–	–	–	–	–	10,365
Items in the course of collection from other banks	9,267	–	–	–	–	–	9,267
Loans and advances to banks	8,658	1,370,000	130,000	105,000	–	–	1,613,658
Loans and advances to customers	12,343	2,010,097	332,751	863,248	20,738	–	3,239,177
Current Tax	–	–	10,791	–	–	–	10,791
Prepayments and accrued income	–	2,872	–	–	–	–	2,872
Other assets	–	49,532	–	–	–	120,378	169,910
Right-of-use assets		–	337	–	17,043	–	17,380
Non-financial assets	–	–	–	–	–	14,694	14,694
At 31 Dec 2020	40,633	3,432,501	473,879	968,248	37,781	135,072	5,088,114
Liabilities							
Deposits by banks	34	475,000	700,000	1,085,000	–	–	2,260,034
Customer accounts	2,178,589	–	–	–	–	–	2,178,589
Items in the course of transmission to other banks	3,275	–	–	–	–	–	3,275
Accruals and other financial liabilities	–	3,523	7,444	6,043	106	55,513	72,629
Subordinated liabilities	–	164	–	–	95,000	–	95,164
Provisions	–	25,610	6,711	23,285	–	36,755	92,361
At 31 Dec 2020	2,181,898	504,297	714,155	1,114,328	95,106	92,268	4,702,052

25. Called up share capital

Called up share capital

Marks and Spencer Financial Services plc ordinary shares of £1.00 each, issued and fully paid.

	2021		2020	
	Number	£'000	Number	£'000
Issued, allotted and fully paid up				
Ordinary shares of £1 each				
As at 1 Jan	260,000,000	260,000	260,000,000	260,000
As at 31 Dec	260,000,000	260,000	260,000,000	260,000

No ordinary shares were issued in 2021.

Other equity instruments

Marks and Spencer Financial Services plc additional tier 1 instruments.

	2021 £'000	2020 £'000
£40m Undated Subordinated Additional Tier 1 instrument issued 2016 (callable March 2022) [1]	**40,000**	40,000
£20m Undated Subordinated Additional Tier 1 instrument issued 2017 (callable December 2022) [2]	**20,000**	20,000
£9m Undated Subordinated Additional Tier 1 instrument issued 2019 (callable December 2024) [3]	**9,000**	9,000
At 31 Dec	**69,000**	69,000

[1] *Holder is HSBC Holdings Limited previously HSBC UK Holdings Ltd, transferred on 10th May 2021. The interest rate is fixed at 8.5625%.*

[2] *Holder is HSBC Holdings Limited previously HSBC UK Holdings Ltd, transferred on 10th May 2021. The interest rate is fixed at 5.25%.*

[3] *Holder is HSBC UK Bank plc. The interest rate is fixed at 4.75%.*

All the Entity's additional tier 1 capital instruments are perpetual in nature with a fixed rate of interest. The instruments are repayable, at the option of the Entity, in whole at the initial call date, or on any interest payment date after the initial call date. Interest is payable at the sole discretion of the Entity and is therefore accounted for as equity and included in the Entity's capital base as fully CRD IV compliant additional tier 1 capital.

No additional tier 1 capital instruments were issued during 2021.

26. Contingent liabilities, contractual commitments and guarantees

The following table gives the nominal principal amounts of off-balance sheet transactions:

	2021 £'000 Contract amount	2020 £'000 Contract amount
Commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend[1]	**10,665,948**	11,607,912
At 31 Dec	**10,665,948**	11,607,912

[1] *Movement in the year represents closure of dormant accounts.*

The table above discloses the nominal principal amounts, which represent the maximum amounts at risk should the contracts be fully drawn upon and clients default. As a significant portion of commitments are expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements. The expected credit loss provision relating to commitments under IFRS 9 is disclosed in Note 28.

Contingent liabilities relate to regulatory matters arising out of the Entity's normal business operations.

27. Right-of-use assets

	Right-of-use asset	
	2021 £'000	2020 £'000
Cost		
At 1 Jan	**24,628**	23,159
Lease modifications	**334**	7,567
Reduction of lease term	**–**	(6,098)
Disposals[1]	**(6,465)**	–
As at 31 Dec	**18,497**	24,628
Accumulated depreciation		
At 1 Jan	**7,248**	3,958
Charge for the year	**3,069**	3,290
Disposals	**(3,995)**	–
As at 31 Dec	**6,322**	7,248
Net book value		
At 1 Jan	**17,380**	19,201
As at 31 Dec	**12,175**	17,380

Right-of-use assets include leases in respect of the Entity's office and branch locations.

[1] *Termination of the lease on a building used by the Entity in April 2021 resulted in a cost release of £1.9m and the closure of the M&S Bank branches in M&S Stores in August 2021 resulted in a cost release of £4.3m.*

28. Management of financial risk

All of the Entity's activities involve to varying degrees, the analysis, evaluation, acceptance and management of risks or combination of risks. The most important types of risk include financial risk, which comprises credit risk, liquidity risk and market risk. The management of financial risk and consideration of profitability, cash flows and capital resources form a key element in the Directors' assessment of the Entity as a going concern.

Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty of the Entity fails to meet a payment obligation under a contract. Credit risk arises from direct lending only.

Within the overall framework of the HSBC Group policy, the Entity has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to the business, and the monitoring and reporting of exposures.

The management of the Entity is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to identify problem exposures in order to accelerate remedial action while building a portfolio of high quality risk assets. The Entity's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. Regular reviews are undertaken to assess and evaluate levels of risk concentration.

The Entity's risk rating system facilitates the IRB approach under Basel framework adopted by the Entity to support calculation of the minimum credit regulatory capital requirement.

Credit risk in 2021

The credit risk effects of the Covid-19 outbreak and the UK withdrawal from the EU continue to be carefully followed by the Entity. Certain industry segments have found themselves challenged and this trend is likely to continue, with some customers having been obliged to take on additional borrowing.

Following a temporary pause in the issuance of default notices, this activity has now recommenced.

A summary of current policies and practices regarding credit risk is set out on pages 25-27.

Summary of credit risk

The disclosure below presents the gross carrying/nominal amount of financial instruments to which the impairment requirements in IFRS 9 are applied and the associated allowance for ECL.

The IFRS 9 allowance for ECL has decreased from £245m at 1 January 2021 to £102m at 31 December 2021. The IFRS 9 allowance for ECL at 31 December 2021 comprises of £100m in respect of assets held at amortised cost and £2m in respect of loan commitments. More detailed analysis of ECL can be found on pages 43-52.

The following table provides an overview of the Entity's credit risk exposure.

Summary of financial instruments to which the impairment requirements in IFRS 9 are applied

	2021		2020	
	Gross carrying/ nominal amount	**Allowance for ECL** [1]	Gross carrying/ nominal amount	Allowance for ECL [1]
	£'000	**£'000**	£'000	£'000
Loans and advances to customers at amortised cost	**3,248,248**	**(100,256)**	3,479,622	(240,445)
Loans and advances to banks at amortised cost	**908,547**	**(1)**	1,613,658	–
Other financial assets measured at amortised cost [2]	**49,067**	**–**	72,036	–
Total gross carrying amount on balance sheet	**4,205,862**	**(100,257)**	5,165,316	(240,445)
Loans and other credit related commitments	**10,665,948**	**(1,501)**	11,607,912	(4,072)
Total nominal amount off-balance sheet [3]	**10,665,948**	**(1,501)**	11,607,912	(4,072)
At 31 Dec	**14,871,810**	**(101,758)**	16,773,228	(244,517)

1 *The total ECL is recognised in the loss allowance for the financial asset.*

2 *Other financial assets measured at amortised cost includes cash and balances at central banks, items in the course of collection from other banks and prepayments and accrued income.*

3 *Represents the maximum amount at risk should the contracts be fully drawn upon and clients default.*

The following table provides an overview of the Entity's credit risk by stage and the associated ECL coverage. The financial assets recorded in each stage have the following characteristics:

- Stage 1: Unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.
- Stage 2: A significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.
- Stage 3: Objective evidence of impairment, and are therefore considered to be in default or otherwise credit-impaired on which a lifetime ECL is recognised.

Summary of credit risk by stage distribution and ECL coverage

	Gross carrying/nominal amount			Allowance for ECL			ECL Coverage %		
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3
	£'000	£'000	£'000	£'000	£'000	£'000	%	%	%
Loans and advances to customers at amortised cost	**2,890,947**	**292,652**	**64,649**	**(17,710)**	**(59,270)**	**(23,276)**	**(1)**	**(20)**	**(36)**
Loans and advances to banks at amortised cost	**908,547**	**—**	**—**	**(1)**	**—**	**—**	**—**	**—**	**—**
Other financial assets measured at amortised cost [1]	**49,067**	**—**	**—**	**—**	**—**	**—**	**—**	**—**	**—**
Loan and other credit-related commitments	**10,592,215**	**39,666**	**34,067**	**(1,307)**	**(194)**	**—**	**—**	**—**	**—**
At 31 Dec 2021	**14,440,776**	**332,318**	**98,716**	**(19,018)**	**(59,464)**	**(23,276)**	**—**	**(18)**	**(24)**
Loans and advances to customers at amortised cost	2,687,049	720,137	72,437	(29,509)	(175,733)	(35,203)	(1)	(24)	(49)
Loans and advances to banks at amortised cost	1,613,658	—	—	—	—	—	—	—	—
Other financial assets measured at amortised cost [1]	72,036	—	—	—	—	—	—	—	—
Loan and other credit-related commitments	11,531,860	46,125	29,927	(3,852)	(220)	—	—	—	—
At 31 Dec 2020	15,904,603	766,262	102,364	(33,361)	(175,953)	(35,203)	—	(23)	(34)

[1] *Other financial assets includes cash and balances at central banks, items in the course of collection from other banks and prepayments and accrued income.*

Unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when they are 30 days past due ('DPD') and are transferred from Stage 1 to Stage 2. The following disclosure presents the ageing of Stage 2 financial assets. It distinguishes those assets that are classified as Stage 2 when they are less than 30 days past due (1-29 DPD) from those that are due to ageing and are more than 30 DPD (30 and >DPD). Past due financial instruments are those loans where customers have failed to make payments in accordance with the contractual terms of their facilities.

Stage 2 days past due analysis at 31 December 2021

	Gross carrying/nominal amount				Allowance for ECL				ECL coverage %			
	Stage 2	*Of which*	*Of which*	*Of which*	Stage 2	*Of which*	*Of which*	*Of which*	Stage 2	*Of which*	*Of which*	*Of which*
		Up-to-date	1 to 29 DPD[1]	30 and > DPD[1]		Up-to-date	1 to 29 DPD[1]	30 and > DPD[1]		Up-to-date	1 to 29 DPD[1]	30 and > DPD[1]
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	%	%	%	%
Loans and advances to customers at amortised cost	**292,652**	**270,954**	**13,786**	**7,912**	**(59,270)**	**(48,952)**	**(4,926)**	**(5,392)**	**20.3**	**18.1**	**35.7**	**68.1**

[1] *The days past due amounts presented above are on a contractual basis and include the benefit of any customer relief payment holidays granted.*

Stage 2 days past due analysis at 31st December 2020

	Gross carrying/nominal amount				Allowance for ECL				ECL coverage %			
	Stage 2	*Of which*	*Of which*	*Of which*	Stage 2	*Of which*	*Of which*	*Of which*	Stage 2		*Of which*	*Of which*
		Up-to-date	1 to 29 DPD	30 and > DPD		Up-to-date	1 to 29 DPD	30 and > DPD		Up-to-date	1 to 29 DPD	30 and > DPD
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	%	£'000	%	%
Loans and advances to customers at amortised cost	720,137	689,614	18,466	12,057	(175,733)	(158,224)	(9,080)	(8,429)	(24.4)	(22.9)	(49.2)	(69.9)

Concentration of credit risk exposure

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. A number of controls and measures are used to minimise undue concentration of exposure in the portfolios across industry, country and customer groups. These include portfolio and counterparty limits, approval and review controls, and stress testing.

Due to the retail-based nature of its lending activities, the Entity is not exposed to any significant concentration risk.

Concentration of exposures

The diversification of the Entity's lending portfolio and range of products ensures that there is no over dependence on any one segment to generate growth in 2021.

Loans and advances to customers and banks held at amortised cost

The table on page 43 analyses loans and advances to show any concentration of credit risk exposures.

Items in the course of collection from other banks

Settlement risk arises in any situations where a payment in cash, securities or equities is made with the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of transactions with each counterparty on any single day.

Measurement uncertainty and sensitivity analysis of ECL estimates

Despite a broad recovery in economic conditions during 2021, ECL estimates continue to be subject to a high degree of uncertainty, and management judgements and estimates continue to reflect a degree of caution, both in the selection of economic scenarios and their weightings, and through judgemental adjustments. Releases of provisions were made progressively as economic conditions recovered, and by 31 December 2021 the majority of the 2020 uplift in ECL provisions had been reversed. By the end of 2021, the Entity retained none of the £110.7m uplift in stage 1 and stage 2 ECL provisions on loans made during 2020.

The recognition and measurement of ECL involves the use of significant judgement and estimation. We form multiple economic scenarios based on economic forecasts, apply these assumptions to credit risk models to estimate future credit losses, and probability-weight the results to determine an unbiased ECL estimate. Management judgemental adjustments are used to address late-breaking events, data and model limitations, model deficiencies and expert credit judgements.

Methodology

Four economic scenarios have been used to capture the current economic environment and to articulate management's view of the range of potential outcomes. Scenarios produced to calculate ECL are aligned to HSBC Group's top and emerging risks.

In the second quarter of 2020, to ensure that the severe risks associated with the pandemic were appropriately captured, management added a fourth, more severe, scenario to use in the measurement of ECL. Starting in the fourth quarter of 2021, HSBC Group's methodology has been adjusted so that the use of four scenarios, of which two are downside scenarios, is the standard approach to ECL calculation.

Three of the scenarios are drawn from consensus forecasts and distributional estimates. The Central scenario is deemed the 'most likely' scenario, and usually attracts the largest probability weighting, while the outer scenarios represent the tails of the distribution, which are less likely to occur. The Central scenario is created using the average of a panel of external forecasters. Consensus Upside and Downside scenarios are created with reference to distributions for select markets that capture forecasters' views of the entire range of outcomes. In the later years of the scenarios, projections revert to long-term consensus trend expectations. In the consensus outer scenarios, reversion to trend expectations is done mechanically with reference to historically observed quarterly changes in the values of macroeconomic variables.

The fourth scenario, Downside 2, is designed to represent management's view of severe downside risks. It is a globally consistent, narrative driven scenario that explores more extreme economic outcomes than those captured by the consensus scenarios. In this scenario, variables do not, by design, revert to long-term trend expectations. They may instead explore alternative states of equilibrium, where economic activity moves permanently away from past trend.

The consensus, Upside scenarios is constructed to be consistent with a 10% probability. The Downside and Downside 2 scenarios are constructed with a 15% probability respectively. The Central Scenario is assigned the remaining 60%. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances. Management may, however, depart from this probability based scenario weighting approach when the economic outlook is determined to be particularly uncertain and risks are elevated.

Description of consensus economic scenarios

The economic assumptions presented in this section have been formed by HSBC Group with reference to external forecasts specifically for the purpose of calculating ECL.

The global economy experienced a recovery in 2021, following an unprecedented contraction in 2020. Restrictions to mobility and travel have eased, aided by the successful roll-out of Covid-19 vaccination programmes. Vaccinations have shown their effectiveness in lowering hospitalisations and deaths enabling the UK economy to reopen. The emergence of new variants that potentially reduce the efficacy of vaccines remains a risk.

Economic forecasts remain subject to a high degree of uncertainty. Risks to the economic outlook are dominated by the progression of the pandemic, vaccine roll-out and the public policy response. Continued uncertainty over the long-term economic relationship between the UK and EU also present downside risks.

The scenarios used to calculate ECL in the Annual Report and Accounts 2021 are described below.

The consensus Central scenario

HSBC UK's Central scenario features a continued recovery in economic growth in 2022 as activity and employment gradually return to the levels reached prior to the outbreak of Covid-19.

The Central scenario assumes that the stringent restrictions on activity, imposed across UK in 2020 and early 2021 are not repeated. The new viral strain, that emerged late in 2021, Omicron, has only a limited impact on the recovery. Consumer spending and business investment, supported by elevated levels of private sector savings, are expected to drive the economic recovery as fiscal and monetary policy support recedes.

UK GDP is expected to grow by 5% in 2022 in the Central scenario and the average rate of UK GDP growth is 2.5% over the five-year forecast period.

The key features of the Central scenario are:

- Growth in UK GDP in 2022. Economic activity continues to recover. GDP grows at a moderate rate and exceeds pre-pandemic levels in 2022.
- Unemployment declines to levels only slightly higher than existed pre-pandemic.
- Covid-19 related fiscal spending recedes in 2022 as fewer restrictions on activity allow fiscal support to be withdrawn.
- Inflation remains elevated through 2022. Supply driven price pressures persist through the first half of 2022 before gradually easing. In subsequent years, inflation quickly converges back towards target rates.
- Bank of England base rate rise gradually over our projection period, in line with economic recovery.

In the longer-term, growth reverts back towards similar rates that existed prior to the pandemic, suggesting that the damage to long-term economic prospects is expected to be minimal.

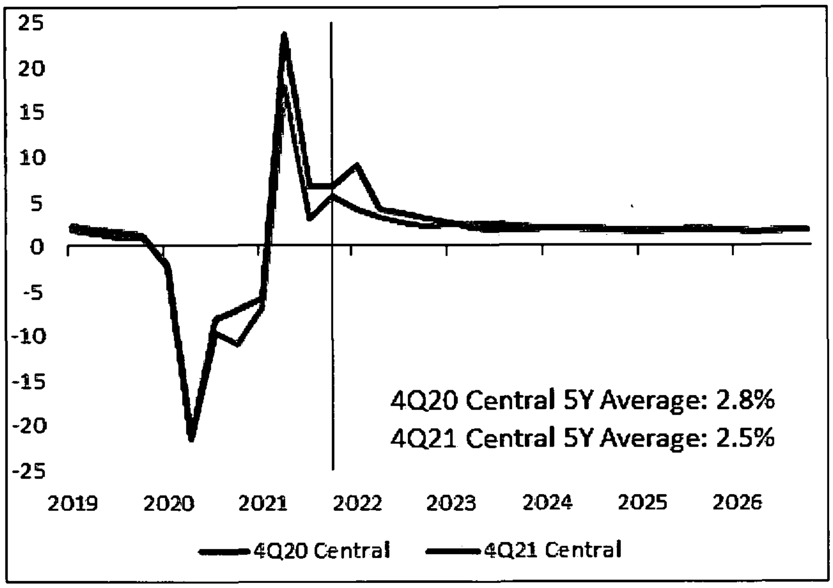
The Central scenario was first created with forecasts available in November, and subsequently updated in December. Probability weighting assigned to the Central scenario is 60%.

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Central scenario applied at 31 December 2021 and 31 December 2020.

Central scenario	**Average 2022 Q1-2026 Q4**	Average 2021 Q1-2025 Q4
	UK%	UK%
GDP growth rate	**2.5**	2.8
Unemployment	**4.3**	5.6
Short term interest rate	**1.2**	0.2
House price growth	**3.5**	1.9
Probability	**60**	40

The graphs comparing the respective Central scenarios in the fourth quarters of 2020 and 2021 reveal the extent of economic dislocation that occurred in 2020 and compares current economic expectations with those held a year ago.

GDP growth: Comparison



The consensus Upside scenario

Compared with the consensus Central scenario, the consensus Upside scenario features a faster recovery in economic activity during the first two years, before converging to long-run trend expectations.

The scenario is consistent with a number of key upside risk themes. These include the orderly and rapid global abatement of Covid-19 via successful containment and ongoing vaccine efficacy; continued fiscal and monetary policy support and smooth relations between the UK and the EU.

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Upside scenario applied at 31 December 2021.

Consensus Upside scenario best outcome

	UK%
GDP growth rate	**9.9 (1Q22)**
Unemployment	**3.0 (4Q23)**
Short term interest rate	**0.7 (1Q22)**
House price growth	**7.4 (2Q23)**
Probability	**10**

Note: extreme point in the consensus Upside is 'best outcome' in the scenario, i.e. highest GDP growth, lowest unemployment rate etc., in first two years of the scenario.

The Downside scenarios

The progress of the pandemic and the ongoing public policy response continues to be a key source of risk. Downside scenarios assume that new strains of the virus result in an acceleration in infection rates and increased pressure on public health services, necessitating restrictions on activity. The reimposition of such restrictions could be assumed to have damaging effect on consumer and business confidence.

Government fiscal programmes in 2020 and 2021 were supported by accommodative actions taken by the Bank of England. These measures have provided households and firms with significant support. An inability or unwillingness to continue with such support or the untimely withdrawal of support present a downside risk to growth.

While Covid-19 and related risks dominate the economic outlook, continued uncertainty over the long-term economic relationship between the UK and EU also present a threat. Potential disagreements between the UK and the EU may hinder the ability to reach a more comprehensive agreement on trade and services, despite the Trade and Cooperation Agreement averting a disorderly UK departure.

The consensus Downside scenario

In the consensus Downside scenario, economic recovery is considerably weaker compared with the Central scenario. GDP growth is expected to be lower, unemployment rates rise moderately and asset and commodity prices fall before gradually recovering towards their long-run trend expectations.

The scenario is consistent with the key downside risks articulated above. Further outbreaks of Covid-19, coupled with delays in the vaccination programme, lead to longer-lasting restrictions on economic activity in this scenario. Other global risks also increase and drive increased risk-aversion in asset markets.

The following table describes key macroeconomic variables and the probabilities assigned in the Consensus Downside scenario applied at 31 December 2021.

Consensus Downside scenario worst outcome

	UK%
GDP growth rate	**(0.5) (3Q23)**
Unemployment	**5.6 (4Q22)**
Short term interest rate	**0.2 (4Q23)**
House price growth	**(4.2) (1Q23)**
Probability	**15**

Note: extreme point in the consensus Downside is 'worst outcome' in the scenario, i.e. lowest GDP growth, highest unemployment rate etc., in first two years of the scenario.

Downside 2 scenarios

The Downside 2 scenario features a deep global recession. In this scenario, new Covid-19 variants emerge that cause infections to rise sharply in 2022, resulting in setbacks to vaccine programmes and the rapid imposition of travel restrictions and lockdowns across some countries. The scenario also assumes UK governments and the Bank of England are unable to significantly increase fiscal and monetary support, which results in abrupt corrections in labour and asset markets.

The table below describes key macro-economic variables and the probability in the Downside 2 scenario applied at 31 December 2021:

Downside 2 worst outcome

	UK%
GDP growth rate	**(4.6) (4Q22)**
Unemployment	**7.5 (2Q23)**
Short term interest rate	**1.6 (2Q22)**
House price growth	**(14.2) (2Q23)**
Probability	**15**

Note: extreme point in the Downside is 2 'worst outcome' in the scenario, i.e. lowest GDP growth and the highest unemployment rate, in the first two years of the scenario.

Scenario weighting

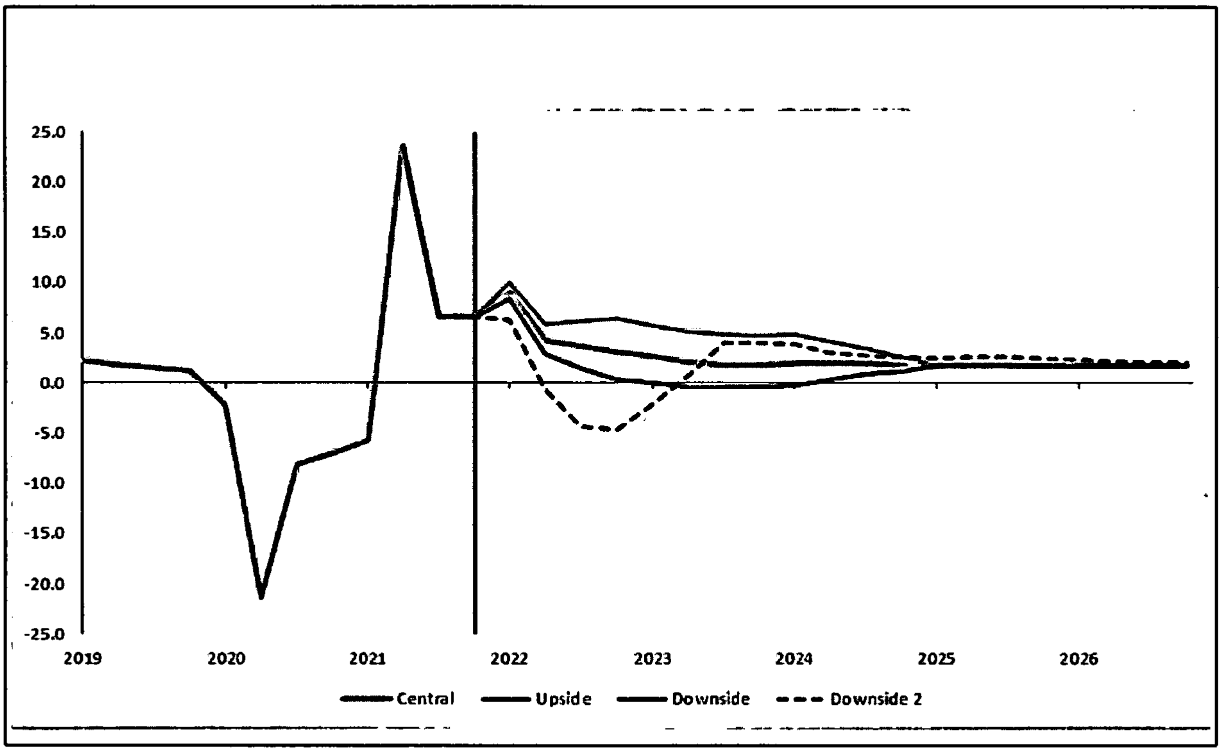
In reviewing the economic conjuncture, the level of uncertainty and risk, management has considered both global and UK specific factors. This has led management to assign scenario probabilities that are tailored to its view of uncertainty in individual markets.

To inform its view, management has considered the progression of the virus in the UK, the speed of vaccine roll-outs, the degree of current and expected future government support and the connectivity with other countries. Management has also been guided by the policy response and UK economic performance through the pandemic, as well as the evidence that UK economy has adapted as the virus has progressed.

A key consideration in the fourth quarter was the emergence of the new variant, Omicron. The virulence and severity of the new strain, in addition to the continued efficacy of vaccines against it, was unknown when the variant first emerged. Management therefore determined that uncertainty attached to forecasts had increased and sought to reflect this in scenario weightings.

The UK faces the significant economic uncertainty. The emergence of Omicron exacerbated the rise in case rates and hospitalisations in UK, necessitating the imposition of new restrictions. These increase uncertainty around economic growth and employment. Accordingly, the Central scenario is assigned 60% weight. The two Downside scenarios were given a combined probability weighting of 30%. The following graphs show the historical and forecasted GDP growth rate for the various economic scenarios.

The following graphs show the historical and forecasted GDP growth rate for the various economic scenarios.



Critical accounting estimates and judgements

• the selection and weighting of economic scenarios, given rapidly changing economic conditions in an unprecedented manner, uncertainty as to the effect of government and the Bank of England support measures designed to alleviate adverse economic impacts, and a wider distribution of economic forecasts than before the pandemic. The key judgements are the length of time over which the economic effects of the pandemic will occur, the speed and shape of recovery. The main factors include the effectiveness of pandemic containment measures, the pace of roll-out and effectiveness of vaccines, and the emergence of new variants of the virus, plus a range of geopolitical uncertainties, which together represent a very high degree of estimation uncertainty, particularly in assessing Downside scenarios;

• estimating the economic effects of those scenarios on ECL, where there is no observable historical trend that can be reflected in the models that will accurately represent the effects of the economic changes of the severity and speed brought about by the Covid-19 pandemic and the recovery from those conditions. Modelled assumptions and linkages between economic factors and credit losses may underestimate or overestimate ECL in these conditions, and there is significant uncertainty in the estimation of parameters such as collateral values and loss severity; and

• the identification of customers experiencing significant increases in credit risk and credit impairment, particularly where those customers have accepted payment deferrals and other reliefs designed to address short-term liquidity issues given muted default experience to date. The use of segmentation techniques for indicators of significant increases in credit risk involves significant estimation uncertainty.

How economic scenarios are reflected in the calculation of ECL

HSBC Group have developed and implemented a globally consistent methodology for incorporating forecasts of economic conditions into ECL estimates. The impact of economic scenarios on PD is modelled at a portfolio level. Historical relationships between observed default rates and macroeconomic variables are integrated into IFRS 9 ECL estimates by using economic response models. The impact of these scenarios on PD is modelled over a period equal to the remaining maturity of underlying asset or assets.

These models are based largely on historical observations and correlations with default rates. Management judgemental adjustments are described below.

Management judgemental adjustments

In the context of IFRS 9, management judgemental adjustments are short-term increases or decreases to the ECL at either a customer, segment or portfolio level to account for late breaking events, model and data limitations and deficiencies, and expert credit judgement applied following management review and challenge.

At 31 December 2021, management judgements were applied to reflect credit risk dynamics not captured by our models. The drivers of the management judgemental adjustments reflect the changing economic outlook and evolving risks across UK.

Where the macroeconomic and portfolio risk outlook continues to improve, supported by low levels of observed defaults, adjustments initially taken to reflect increased risk expectations have been retired or reduced.

However, other adjustments have increased where modelled outcomes are overly sensitive and not aligned to observed changes in the risk of the underlying portfolios during the pandemic, or where sector-specific risks are not adequately captured.

We have internal governance in place to monitor management judgemental adjustments regularly and, where possible, to reduce the reliance on these through model recalibration or redevelopment, as appropriate.

Management judgemental adjustments made in estimating the scenario-weighted reported ECL at 31 December 2021 are set out in the following table. The table includes adjustments in relation to data and model limitations, including those driven by late-breaking events and sector specific risks and as a result of the regular process of model development and implementation.

Management judgemental adjustments to ECL[1]	2021 £'000	2020 £'000
Retail lending PD adjustments	–	(113)
Retail model default timing adjustment	–	190
Macroeconomic-related adjustments	3	–
Pandemic-related economic recovery adjustments	5	–
Other retail lending adjustments	10	(3)
Total	**18**	74

[1] *Management judgemental adjustments presented in the table reflect increases or (decreases) to ECL,respectively.*

Management judgemental adjustments at 31 December 2021 caused an increase to ECL of £18m. During 2021, management judgemental adjustments reflected an evolving macroeconomic outlook and the relationship of the modelled ECL to this outlook and to late-breaking and sector specific risks.

The decrease in adjustment impact relative to 31 December 2020 was mostly driven by management judgements as a result of the effect of further improvement of macroeconomic scenarios on modelled outcomes and increased dislocation of modelled outcomes to management expectations for high-risk sectors and due to late-breaking events not fully reflected in the underlying data. At 31 December 2021, management judgemental adjustments were an ECL increase of £18m (31 December 2020: £74m increase).

• £113m adjustment for retail lending PD model outputs and £190m adjustment for default suppression have been discontinued in 2021. The need for these adjustments was driven by the interaction of severe economic conditions with modelled outputs, but as the economic outlook has now improved significantly, these adjustments are no longer required.

• Macroeconomic-related adjustments increased ECL by £3m (31 December 2020: £0m). These were applied to reflect management concern about specific risks not fully captured by models including inflation. As inflation is increasing in the UK, particularly in essential areas such as energy costs, there is likely to be an impact on customer affordability and therefore a Forward Economic Guidance (FEG) ECL adjustment has been modelled for inclusion in 2021. This adjustment has been calculated by uplifting PD and LGD metrics to reflect delinquency levels observed in customers identified as having limited affordability, evidenced through ability to absorb a 5% increase in the cost of essential services.

• Pandemic-related economic recovery adjustments increased ECL by £5m (31 December 2020: £0m) to adjust for the effects of the volatile pace of recovery from the pandemic. This is where in management's judgement, supported by quantitative analysis of portfolio and economic metrics, modelled outcomes are overly sensitive given the limited observed deterioration in the underlying portfolio during the pandemic.

• Other retail lending adjustments increased ECL by £10m (31 December 2020: £3m decrease). These were primarily to address areas such as model recalibration and redevelopment, customer relief and data limitations, including a high risk sector adjustment.

Economic scenarios sensitivity analysis of ECL estimates

Management considered the sensitivity of the ECL outcome against the economic forecasts as part of the ECL governance process by recalculating the ECL under each scenario described above for selected portfolios, applying a 100% weighting to each scenario in turn. The weighting is reflected in both the determination of a significant increase in credit risk and the measurement of the resulting ECL.

The ECL calculated for the Upside and Downside scenarios should not be taken to represent the upper and lower limits of possible ECL outcomes. The impact of defaults that might occur in the future under different economic scenarios is captured by recalculating ECL for loans at the balance sheet date.

There is a particularly high degree of estimation uncertainty in numbers representing tail risk scenarios when assigned a 100% weighting.

Sensitivity analysis

The sensitivity analysis is stated inclusive of management judgemental adjustments, as appropriate to each scenario. The comparative period results for Downside 2 scenarios are not directly comparable to the current period, because they reflect different risk profiles relative with the Consensus scenarios for the period end.

IFRS 9 ECL sensitivity to future economic conditions[1]	2021	2020
	UK	UK
	£m	£m
ECL of loans and advances to customers at 31 December 2021		
Reported ECL	**102**	245
Consensus Scenarios		
Central scenario	**82**	213
Upside scenario	**68**	140
Downside scenario	**106**	257
Downside 2 scenario	**246**	308

[1] *ECL sensitivities exclude portfolios utilising less complex modelling approaches.*

Credit cards and other unsecured lending are sensitive to economic forecasts, which have improved in 2021.

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments

The following disclosure provides a reconciliation by stage of the Entity's gross carrying/nominal amount and allowances for loans and advances to banks and customers, including loan commitments.

The transfers of financial instruments represents the impact of stage transfers upon the gross carrying/nominal amount and associated allowance for ECL. The net remeasurement of ECL arising from stage transfers represents the increase or decrease in ECL due to these transfers, for example, moving from a 12-month (stage 1) to a lifetime (stage 2) ECL measurement basis. Net remeasurement excludes the underlying PD movements of the financial instruments transferring stage. This is captured, along with other credit quality movements in the 'changes to risk parameters – credit quality' line item.

The 'new financial assets originated or purchased', 'changes to risk parameters - further lending/repayments' and 'assets derecognised (including final repayments)' represent the gross carrying/nominal amount and associated allowance ECL impact from volume movements within the Entity's lending portfolio.

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments

	Non credit impaired				Credit impaired		Total	
	Stage 1		Stage 2		Stage 3			
	Gross carrying/ nominal amount £'000	Allowance for ECL £'000	Gross carrying/ nominal amount £'000	Allowance for ECL £'000	Gross carrying/ nominal amount £'000	Allowance for ECL £'000	Gross carrying/ nominal amount £'000	Allowance for ECL £'000
At 1 Jan 2021	**15,832,566**	**(33,361)**	**766,262**	**(175,954)**	**102,364**	**(35,202)**	**16,701,192**	**(244,517)**
Transfer of financial instruments								
- transfers from stage 1 to stage 2	**(1,581)**	**29**	**1,581**	**(29)**	**–**	**–**	**–**	**–**
- transfers from stage 2 to stage 1	**3,001**	**(416)**	**(3,001)**	**416**	**–**	**–**	**–**	**–**
- transfers to stage 3	**–**	**–**	**(40)**	**21**	**40**	**(21)**	**–**	**–**
- transfers from stage 3	**44**	**(9)**	**66**	**(37)**	**(110)**	**46**	**–**	**–**
Net remeasurement of ECL arising from transfer of stage	**–**	**263**	**–**	**(67)**	**–**	**–**	**–**	**196**
New financial assets originated or purchased	**656,174**	**(10,857)**	**–**	**–**	**–**	**–**	**656,174**	**(10,857)**
Changes to risk parameters- further lending/ repayments	**(1,477,112)**	**680**	**130,573**	**25,663**	**76,129**	**10,569**	**(1,270,410)**	**36,912**
Changes to risk parameters (credit quality)	**–**	**24,163**	**–**	**22,190**	**–**	**(64,315)**	**–**	**(17,962)**
Asset derecognised (including final repayments)	**(413,366)**	**490**	**(561,152)**	**68,333**	**(14,656)**	**596**	**(989,174)**	**69,419**
Assets written off	**–**	**–**	**–**	**–**	**(65,051)**	**65,051**	**(65,051)**	**65,051**
Transfer of Mortgage book	**(208,017)**	**–**	**(1,971)**	**–**	**–**	**–**	**(209,988)**	**–**
At 31 Dec 2021	**14,391,709**	**(19,018)**	**332,318**	**(59,464)**	**98,716**	**(23,276)**	**14,822,743**	**(101,758)**
ECL release/(charge) for the period		**14,739**	**–**	**116,119**	**–**	**(53,150)**		**77,708**
Recoveries		**–**		**–**		**20,036**		**20,036**
Total change in ECL for the period		**14,739**		**116,119**		**(33,114)**		**97,744**

At 1 Jan 2020	16,278,785	(13,291)	712,180	(85,366)	97,672	(29,738)	17,088,637	(128,395)
Transfer of financial instruments							115	1
- transfers from stage 1 to stage 2	(241,388)	1,784	241,388	(1,784)	—	—	—	—
- transfers from stage 2 to stage 1	262,915	(11,886)	(262,915)	11,886	—	—	—	—
- transfers to stage 3	—	—	(10,169)	5,063	10,284	(5,063)	115	—
- transfers from stage 3	3	(2)	699	(575)	(702)	578	—	1
Net remeasurement of ECL arising from transfer of stage	—	5,778	—	(2,563)	—	—	—	3,215
New financial assets originated or purchased	2,018,158	(23,743)	—	—	—	—	2,018,158	(23,743)
New and further lending/repayments	(656,307)	3,020	85,079	(18,643)	51,289	(9,001)	(519,939)	(24,624)
Changes to risk parameters (credit quality)	—	(15,589)	—	(83,972)	—	(48,157)	—	(147,718)
Change in model used for ECL calculation	—	—	—	—	—	—	—	—
Asset derecognised (including final repayments)	(1,829,600)	20,568	—	—	—	—	(1,829,600)	20,568
Assets written off	—	—	—	—	(56,179)	56,179	(56,179)	56,179
At 31 Dec 2020	15,832,566	(33,361)	766,262	(175,954)	102,364	(35,202)	16,701,307	(244,516)
ECL release/(charge) for the period		(9,966)		(105,178)		(57,158)		(172,302)
Recoveries		—		—		16,454		16,454
Total change in ECL for the period		(9,966)		(105,178)		(40,704)		(155,848)

[1] *For the purposes of this disclosure, gross carrying value is defined as the amortised cost of a financial asset before adjusting for any loss allowance. The reconciliation includes loans and advances to other HSBC Group companies. As at 31 December 2021, these amounted to £0.9bn (2020: £1.6bn) and were classified as stage 1 with no ECL. The reconciliation excludes other financial assets measured at amortised cost. As at 31 December 2021, these amounted to £49m (2020: £72m) and were classified as Stage 1 with no ECL.*

Credit quality

Credit quality of financial instruments

The Entity assesses the credit quality of all financial instruments that are subject to credit risk. The credit quality of financial instruments is a point-in-time assessment of the PD of financial instruments, whereas stages 1 and 2 are determined based on relative deterioration of credit quality since initial recognition.

The five credit quality classifications defined below each encompass a range of granular internal credit rating grades assigned to the lending business and the external ratings attributed by external agencies to debt securities, as shown in the table below.

Credit quality classification

	Debt Securities and other bills	Lending	
Quality classification	**External credit rating**	**Internal credit rating**	**12-month probability-weighted PD %[1]**
Strong	**A- and above**	**Band 1 and 2**	**0.000-0.500**
Good	**BBB+ to BBB-**	**Band 3**	**0.501-1.500**
Satisfactory	**BB+ to B and unrated**	**Band 4 and 5**	**1.501-20.000**
Sub-standard	**B- to C**	**Band 6**	**20.001-99.999**
Credit-impaired	**Default**	**Band 7**	**100.000**

[1] *12-month point-in-time probability-weighted probability of default ('PD')*

Quality classification definitions

- 'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default.
- 'Good' exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk.
- 'Satisfactory' exposures require closer monitoring and demonstrate an average-to-fair capacity to meet financial commitments, with moderate default risk.
- 'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern.
- 'Credit-impaired' exposures have been assessed as impaired.

Distribution of financial instruments by credit quality

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Substandard	Credit impaired	Total	Allowance provision for ECL	Net
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Loans and advances to banks	908,547	–	–	–	–	908,547	(1)	908,546
Loans and advances to customers	1,738,762	688,711	722,671	33,455	64,649	3,248,248	(100,256)	3,147,992
Other financial assets held at amortised cost [1]	49,067	–	–	–	–	49,067	–	49,067
At 31 Dec 2021	2,696,376	688,711	722,671	33,455	64,649	4,205,862	(100,257)	4,105,605
Loan and other credit related commitments for loans and advances to customers	10,170,580	327,806	129,085	4,410	34,067	10,665,948	(1,501)	10,664,447
Loans and advances to banks	1,613,658	–	–	–	–	1,613,658	–	1,613,658
Loans and advances to customers	1,136,098	709,034	1,373,510	188,543	72,437	3,479,622	(240,445)	3,239,177
Other financial assets held at amortised cost [1]	72,036	–	–	–	–	72,036	–	72,036
Other assets	72,036	–	–	–	–	72,036	–	72,036
At 31 Dec 2020	2,821,792	709,034	1,373,510	188,543	72,437	5,165,316	(240,445)	4,924,871
Loan and other credit related commitments for loans and advances to customers	11,030,913	379,518	162,005	5,549	29,927	11,607,912	(4,072)	11,603,840

[1] Other financial assets held at amortised cost includes cash and balances at central banks, items in the course of collection from other banks and prepayments and accrued income.

Distribution of financial instruments to which the impairment requirements of IFRS 9 are applied by credit quality and stage allocation

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Substandard	Credit impaired	Total	Allowance provision for ECL	Net
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Loans and advances to banks at amortised cost	908,547	–	–	–	–	908,547	(1)	908,546
- stage 1	908,547	–	–	–	–	908,547	(1)	908,546
Loans and advances to customers at amortised cost	1,738,761	688,711	722,671	33,456	64,649	3,248,248	(100,256)	3,147,992
- stage 1	1,738,761	688,711	463,475	–	–	2,890,947	(17,710)	2,873,237
- stage 2	–	–	259,196	33,456	–	292,652	(59,270)	233,382
- stage 3	–	–	–	–	64,649	64,649	(23,276)	41,373
Other financial assets measured at amortised cost1	49,067	–	–	–	–	49,067	–	49,067
- stage 1	49,067	–	–	–	–	49,067	–	49,067
Loans and other credit related commitments	10,170,580	327,806	129,085	4,410	34,067	10,665,948	(1,501)	10,664,447
- stage 1	10,170,580	327,806	93,825	4	–	10,592,215	(1,307)	10,590,908
- stage 2	–	–	35,260	4,406	–	39,666	(194)	39,472
- stage 3	–	–	–	–	34,067	34,067	–	34,067
At 31 Dec 2021	12,866,955	1,016,517	851,756	37,866	98,716	14,871,810	(101,758)	14,770,052
Loans and advances to banks at amortised cost	1,613,658	–	–	–	–	1,613,658	–	1,613,658
- stage 1	1,613,658	–	–	–	–	1,613,658	–	1,613,658
Loans and advances to customers at amortised cost	1,136,097	709,034	1,373,510	188,543	72,437	3,479,622	(240,445)	3,239,177
- stage 1	1,136,097	709,034	841,917	–	–	2,687,048	(29,509)	2,657,538
- stage 2	–	–	531,593	188,543	–	720,137	(175,733)	544,404
- stage 3	–	–	–	–	72,437	72,437	(35,203)	37,235
Other financial assets measured at amortised cost1	72,036	–	–	–	–	72,036	–	72,036
- stage 1	72,036	–	–	–	–	72,036	–	72,036
Loans and other credit related commitments	11,030,914	379,518	162,005	5,549	29,927	11,607,912	(4,072)	11,603,840
- stage 1	11,030,914	379,518	121,429	–	–	11,531,860	(3,852)	11,528,008
- stage 2	–	–	40,576	5,549	–	46,125	(220)	45,905
- stage 3	–	–	–	–	29,927	29,927	–	29,927
At 31 Dec 2020	13,852,705	1,088,551	1,535,515	194,093	102,364	16,773,228	(244,517)	16,528,711

[1] Other financial assets measured at amortised cost include cash and balances at central banks, items in the course of collection from other banks and prepayments and accrued income.

[2] For the purposes of this disclosure gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance.

Credit impaired loans

The Entity determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as when a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default. If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit impaired.

Renegotiated loans and forbearance

'Forbearance' describes concessions made on the contractual terms of a loan in response to an obligor's financial difficulties.

A loan is classed as 'renegotiated' when we modify the contractual payment terms on concessionary terms because we have significant concerns about the borrowers' ability to meet contractual payments when due. Non-payment-related concessions (e.g. covenant waivers), whilst potential indicators of impairment, do not trigger identification as renegotiated loans under our existing disclosures.

Where customers are in (or approaching) financial difficulty, due consideration is given to provide assistance to customers (either on a temporary or permanent basis) to help them meet the contractual commitments relating to their account. The Entity's policy provides guidance on when customers are considered to be in financial difficulty and the various forbearance tools that are available to assist them. It is recognised that customers find themselves in financial difficulties as a result of many different situations and the Financial Support Team, speaking with customers, will often be best placed to understand the individual circumstances and needs of specific customers. Prior to agreeing a forbearance, an appropriate level of assessment on a customer's affordability is completed to ensure any solution agreed with the customer is suitable, sustainable and will achieve a fair outcome for the customer.

The following table shows the gross carrying amounts of the Entity's holdings of renegotiated loans and advances to customers by stage. Renegotiated loans are deemed to remain credit-impaired until repayment or derecognition. Mandatory and general offer loan modifications that are not borrower-specific, for example market-wide customer relief programmes, have not been classified as renegotiated loans.

	At 31 Dec 2021				At 31 Dec 2020			
	Neither past due not impaired	**Past due but not impaired**	**Impaired**	**Total**	Neither past due not impaired	Past due but not impaired	Impaired	Total
	£'000	**£'000**	**£'000**	**£'000**	£'000	£'000	£'000	£'000
Retail	**—**	**—**	**19,513**	**19,513**			26,526	26,526
- Renegotiated loans	**—**	**—**	**19,513**	**19,513**			26,526	26,526
Impairment allowance on renegotiated loans				**(7,390)**				(13,600)
Renegotiated loans and advances as % of total gross loans (%)				**0.6**				0.8

Market risk management

Market risk is the risk that movements in market factors including interest rates and foreign exchange rates will impact the Entity's income or the value of its portfolios.

The Entity's objective is to manage and control market rate exposures while maintaining a market profile consistent with its risk appetite.

Interest rate risk

Interest rate risk is managed by matching the re-price maturity profile of assets and liabilities using a behavioural basis. Maturity mismatches are managed through deposits and borrowings to ensure the financial exposure of the Entity within approved limits.

At 31 Dec 2021	Not more than 3 months £'000	Between 3 and 6 months £'000	Between 6 months and 1 year £'000	Between 1 and 5 years £'000	More than 5 years £'000	Non-interest bearing £'000	Total £'000
Assets							
Loans and advances to banks	**654,547**	**55,000**	**55,000**	**144,000**	**–**	**–**	**908,547**
Loans and advances to customers	**541,782**	**532,214**	**283,221**	**1,298,169**	**17,419**	**475,187**	**3,147,992**
Other assets	**40,591**	**345**	**614**	**2,153**	**101**	**105,238**	**149,042**
Total assets	**1,236,920**	**587,559**	**338,835**	**1,444,322**	**17,520**	**580,425**	**4,205,581**
Liabilities							
Deposits by banks	**440,000**	**430,000**	**260,000**	**1,270,000**	**–**	**–**	**2,400,000**
Customer accounts	**714,669**	**177,512**	**78,662**	**102,911**	**–**	**11,679**	**1,085,433**
Other liabilities	**83,102**	**–**	**–**	**–**	**–**	**65,160**	**148,262**
Subordinated liabilities	**17,367**	**–**	**–**	**79,000**	**–**	**–**	**96,367**
Shareholders' equity	**–**	**–**	**–**	**–**	**–**	**475,519**	**475,519**
Total equity and liabilities	**1,255,138**	**607,512**	**338,662**	**1,451,911**	**–**	**552,358**	**4,205,581**
Interest rate sensitivity gap	**(18,218)**	**(19,953)**	**173**	**(7,589)**	**17,520**	**28,067**	**–**
Cumulative interest rate sensitivity gap	**(18,218)**	**(38,171)**	**(37,998)**	**(45,587)**	**(28,067)**	**–**	**–**

At 31 Dec 2020	Not more than 3 months £'000	Between 3 and 6 months £'000	Between 6 months and 1 year £'000	Between 1 and 5 years £'000	More than 5 years £'000	Non-interest bearing £'000	Total £'000
Assets							
Loans and advances to banks	1,378,658	60,000	70,000	105,000	–	–	1,613,658
Loans and advances to customers	714,306	673,844	340,025	1,461,544	14,315	35,143	3,239,177
Other assets	81,739	391	695	2,546	128	149,780	235,279
Total assets	2,174,703	734,235	410,720	1,569,090	14,443	184,923	5,088,114
Liabilities							
Deposits by banks	475,034	440,000	260,000	1,085,000	–	–	2,260,034
Customer accounts	1,047,298	269,151	150,067	511,734	–	200,339	2,178,589
Other liabilities	83,631	–	–	–	–	84,634	168,265
Subordinated liabilities	95,164	–	–	–	–	–	95,164
Shareholders' equity	–	–	–	–	–	386,062	386,062
Total equity and liabilities	1,701,127	709,151	410,067	1,596,734	–	671,035	5,088,114
Interest rate sensitivity gap	473,576	25,084	653	(27,644)	14,443	(486,112)	–
Cumulative interest rate sensitivity gap	473,576	498,660	499,313	471,669	486,112	–	–

29. Legal proceedings and other regulatory matters

The Entity is party to legal proceedings and regulatory matters arising out of its normal business operations. The Entity considers that none of these matters are material.

30. Related party transactions

(a) Transactions with Key Management Personnel

Key Management Personnel ('KMP') are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Entity directly and indirectly and include members of the Board of Directors of the Entity, and the Board of Directors of HSBC UK Bank plc.

IAS 24 'Related Party Disclosures' requires the following additional information for key management compensation.

A number of KMP are not directors of the Entity and are paid by other HSBC Group companies which make no recharge to the Entity. It is not possible to make reasonable apportionment of their emoluments in respect of the Entity. Accordingly, no emoluments in respect of these KMP are included in the following disclosure.

Members of the Entity's Exec Co are not considered KMP as it is the body of the Exec Co, not individual members, that has the authority and responsibility for planning, directing and controlling the activities of the Entity. 2021 numbers have been prepared on this basis.

The following represents the compensation for Directors and other Key Management Personnel of the Entity in exchange for services rendered to the Entity for the period they served during the year.

Compensation of Key Management Personnel

	2021	2020
	£'000	£'000
Short-term employee benefits	576	722
Post-employment benefits	25	35

Transactions, arrangements and agreements with Key Management Personnel

The table below sets out transactions which fall to be disclosed under IAS 24 'Related Party Disclosures' between the Entity and its Key Management Personnel.

	2021		2020	
	Highest balance during the year	Balance at 31 December	Highest balance during the year	Balance at 31 December
	£'000	£'000	£'000	£'000
Cards	30	5	31	12
Other [1]	130	102	52	51

[1] Other includes savings and insurance products

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

(b) Transactions with other related parties

Transactions detailed below include amounts due to/from HSBC Bank plc and its subsidiaries

	2021		2020	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Liabilities				
Other liabilities	**4,093**	**3,362**	8,425	2,688

1 The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

	2021	2020
	£'000	£'000
Income statement		
Interest expense	**510**	2,929
Fee income	**11**	98
Other operating income	**(458)**	–
General and administrative expenses	**37,987**	35,319

Transactions detailed below include amounts due to/from HSBC Holdings plc

	2021		2020	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	**£'000**	**£'000**
Liabilities				
Additional tier 1 equity	**60,000**	**60,000**	–	–

1 The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

	2021	2020
	£'000	£'000
Income statement		
Dividend expense	**1,150**	–

Transactions detailed below include amounts due to/from Marks and Spencer Unit Trust Management Limited

	2021		2020	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Assets				
Other assets	**201**	**102**	5,052	5,052
Liabilities				
Other liabilities	**9,619**	**5,197**	10,491	10,491

[1] The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.

	2021	2020
	£'000	£'000
Income statement		
Interest expense	**4**	18
General and administrative expenses	**2,168**	2,820

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Transactions detailed below include amounts due to/from HSBC UK Bank Plc

	2021		2020	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Assets				
Loans and advances to banks	**1,931,543**	**908,547**	2,635,135	1,613,594
Other assets	**36,495**	**19,369**	45,224	35,854
Liabilities				
Deposits by banks	**2,590,000**	**2,400,000**	3,030,000	2,260,000
Subordinated amounts due	**96,367**	**96,367**	16,000	16,000
Additional tier 1 equity	**9,000**	**9,000**	9,000	9,000
Other liabilities	**17,092**	**7,334**	12,151	7,900

[1] *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2021	2020
	£'000	£'000
Income statement		
Interest income	**1,596**	6,201
Interest expense	**13,444**	21,496
Fee income	**(18)**	32
Fee expense	**1,291**	–
General and administrative expenses	**3,351**	3,874

In June 2021 the Entity's mortgage book was transferred at book value to HSBC UK and was agreed by the relevant parties, resulting in no gains or losses.

Transactions detailed below include amounts due to/from HSBC UK Holdings Limited

	2021		2020	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Liabilities				
Subordinated amounts due	**79,595**	**–**	79,733	79,159
Additional tier 1 equity	**60,000**	**–**	60,000	60,000

[1] *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2021	2020
	£'000	£'000
Income statement		
Interest expense	**510**	2,929
Other operating income	**458**	–
Dividend expense	**3,425**	4,575

31. Parent undertakings

The ultimate parent undertaking and ultimate controlling party is HSBC Holdings plc which is the parent undertaking of the largest group to consolidate these financial statements. HSBC UK Bank plc is the parent undertaking of the smallest group to consolidate these financial statements.

All companies are registered in England and Wales.

Copies of HSBC Holdings plc's and HSBC UK Bank plc's consolidated financial statements can be obtained from:

HSBC Holdings plc
8 Canada Square
London E14 5HQ
United Kingdom
www.hsbc.com

HSBC UK Bank plc
1 Centenary Square
Birmingham B1 1HQ
United Kingdom
www.hsbc.com

32. Events after balance sheet date

A dividend in respect of the year ended 31 December 2021 of £27m (£0.10p per share) is recommended by the Directors.