Marks and Spencer Financial Services Plc

Registration No: 1772585

Annual Report and Financial Statements for the year ended 31 December 2022

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.

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 focusses on unsecured lending, customer deposits, currency services and general insurance.

The travel money business has seen a significant improvement in turnover levels, with the Bureaux network reopening and the return of international travel following the lifting of Covid-19 restrictions.

The Entity continues to be impacted by wider economic stresses including inflationary pressures and interest rate rises which has resulted in increases in the Expected Credit Loss ('ECL') impairment provision during the year. The Entity will continue to support customers and employees during this period of stress.

The Entity has continued to work closely with M&S plc and with its parent HSBC Bank UK Plc ('HSBC UK') through a joint transformation programme to develop and drive forward an aligned strategy, leveraging the strengths and capabilities of both businesses. Sparks Pay, a new digital credit account exclusively for M&S plc customers, successfully launched in the year.

Performance

The Entity's results for the year under review are as detailed in the income statement shown on page 16 of these financial statements.

The table below illustrates the differences in reported profit to adjusted profit before tax.

	2022	2021
	£m	£m
Reported profit before tax	**38**	116
Payment Protection Insurance ('PPI') Remediation	**(4)**	11
Business Transformation costs	**1**	9
Collections related Remediation and Provisions	**3**	(5)
Profit Share impact of additional Remediation and Business Transformation Costs	**1**	(7)
Adjusted profit before tax	**39**	124

The entity reported a profit before tax for the year of 2022 of £38m compared to a profit before tax of £116m in 2021.

Excluding customer remediation and costs relating to business transformation, the business generated an adjusted profit before tax of £39m (2021: £124m profit).

The year on year adjusted profit before tax decrease of £85m reflects a £70m increase in net operating income before impairment charges, a £158m increase in Loan impairment charges and a £3m decrease in operating expenses.

The increase on loan impairment charges of £158m is primarily driven by a Forward Economic Guidance ('FEG') ECL movement of £164m with £128m FEG ECL release in 2021 due to improved outlook in economic forecast which is then offset by a £36m FEG ECL increase in 2022 due to the subsequent deterioration in economic outlook.

The upward movement in adjusted net operating income exclusive of ECL of £70m is driven by £59m lower profit share payable and £11m increase in gross operating income versus 2021. Gross operating income increase is driven by net fee income of £23m largely through improved travel money performance as travel restrictions eased post the Covid-19 pandemic. Net interest income has reduced by £12m predominantly on credit cards from increased cost of funds following increases in Bank of England ('BoE') base rate and term funding rates. The in-year profit share movement is driven by a lower overall profit before tax in 2022 driven primarily by the increase seen in loan impairment charges.

Operating expenses have decreased £3m from 2021 driven by benefits generated through transformation and rationalisation of products and channels during 2021. This has been partially offset by increased operating costs in travel money as customer demand increased together with inflationary impacts on staffing and third party suppliers costs.

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

	2022	2021
Profit before tax (£'000)	**38,013**	115,795
Adjusted Profit before tax (£'000)	**39,111**	124,071
Total risk-weighted assets (£'000)	**2,621,405**	2,343,898
Pre-tax return on risk-weighted assets (%)	**1.5**	5.0
Common equity tier 1 (%)	**15.1**	16.6
Cost efficiency ratio (%)	**54.6**	58.6
Return on tangible equity (%)	**5.5**	24.0
Ratio of customer advances to customer deposits (%)	**381.1**	290.0

Adjusted profit before tax ('PBT') excludes customer remediation and business transformation costs.

Pre-tax return on average risk-weighted assets is measured as adjusted PBT divided by average risk-weighted assets. This has decreased year on year due to lower adjusted PBT reported in 2022.

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. The percentage has decreased year on year predominantly due to higher risk weighted assets.

Cost efficiency ratio is measured as total adjusted operating expenses (adjusted for the impact of customer remediation and business transformation costs) divided by adjusted operating income (adjusted for the impact of customer remediation and profit share on adjusting items) before loan impairment.

Return on tangible equity (RoTE) is measured as the profit attributable to ordinary shareholders divided by the reported equity adjusted for intangibles and Additional Tier 1 coupons. The decrease year on year reflects lower 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 higher credit card (£211m) and personal loan (£31m) balances and lower customer deposits (£200m).

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:

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

Key assumptions underpinning these judgements 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 at least 4 times a year (with 11 meetings held in the last year) focussing on risk governance and providing a forward looking view of risks and their mitigation. This supports the Board's role in overseeing risk management by escalating areas outside of risk appetite, areas of concern to the 2nd line risk Stewards and a forward looking view of risks that may impact the delivery of strategic goals to every Board meeting. There is no separate risk committee but there is a regular agenda item for the Chief Risk Officer to present this risk report along with deep-dive papers covering risk areas that require Board focus.

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 risks 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 and set by the Board.

Top and Emerging Risks

Geopolitical and macroeconomic risk

This risk has heightened in 2022 as the UK economy faced a number of challenges including a reduction in economic output, rising inflation, increased interest rates and a period of significant market volatility that followed changes to the policies announced by the UK Government. Against this backdrop, the recovery has stalled, with GDP still below its pre-Covid-19 pandemic level. Consumer confidence has fallen as the cost of living crisis has deepened, partly driven by the sharp rise in energy prices, and with real incomes falling, the economy is expected to go into recession in 2023.

Global commodity markets have been significantly impacted by the Russia Ukraine war and localised Covid-19 outbreaks, leading to lingering supply chain disruptions. These disruptions have resulted in UK product shortages and increased prices for both energy and non-energy commodities, such as food. We do not expect these to ease significantly in the near term. These issues have exacerbated the increased rate of inflation currently being seen in the UK. The BoE is continuing to raise the base rate in order to reduce the inflationary pressures.

Higher inflationary and interest rate expectations in the UK, and the resulting economic environment, have had an impact on ECL and could increase the uncertainty of our modelled ECL estimates. The combined pressure of higher inflation and interest rates may impact the ability of our customers to repay debt. In line with existing practice we have continued to carry out enhanced monitoring of model outputs and the use of model overlays, including management adjustments. These adjustments are based on the expert judgement of senior credit risk managers to reflect current market inflation and interest rate conditions where they have not been incorporated in the underlying macroeconomic scenarios. Inflation and rising interest rates have been considered both directly in certain models, and assessed via adjustments where not directly considered. Whilst UK government programmes implemented during the Covid-19 pandemic to support businesses and individuals have ceased, these have impacted the level of credit losses, which in turn may have impacted the longer-term reliability of loss and capital models.

High Covid-19 vaccination rates and acquired population immunity in 2022 across the UK have minimised the public health risks and the need for restrictions. New Covid-19 variants and sub-variants pose a continuing risk and could result in the UK Government reintroducing restrictions, potentially impacting our personal and business customers.

We continue to monitor our risk profile closely in the context of the current geopolitical and macroeconomic situation, and given the significant uncertainties, additional mitigating actions may be required.

Technology and cybersecurity risk

Together with other organisations, we 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.

We are focussed on improving change control processes and authorised access controls by providing additional education and training to identify and manage vulnerabilities in our software, system configurations, logic and architecture.

Financial Crime and Fraud Risk

Financial institutions remain under considerable regulatory scrutiny regarding their ability to prevent and detect financial crime which continues 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.

We are strengthening and investing in fraud controls, to introduce next generation anti-fraud capabilities to protect both customers and ourselves.

Environmental, social and governance risks

We are subject to financial and non-financial risks associated with environmental, social and governance ('ESG') related matters. Our current areas of focus are climate risk, nature-related risks and human rights risks. These can impact us both directly and indirectly through our customers and our own activities.

HSBC Group's focus on climate-related risk in particular increased over 2022, owing to the pace and volume of policy and regulatory changes on climate risk management, stress testing and scenario analysis and disclosures. Climate change can have an impact across HSBC Group's risk taxonomy through both transition risk, arising from the move to a low-carbon economy, such as through policy, regulatory and technological changes, and physical risk impacts due to increasing severity and/or frequency of severe weather or other climatic events, such as rising sea levels and flooding. These risks have the potential to cause both financial and non-financial impacts for us. Financial impacts could materialise, for example, through greater transactional losses and/or increased capital requirements. Non-financial impacts could materialise if our own assets or operations are impacted by extreme weather or chronic changes in weather patterns, or as a result of business decisions to achieve our Climate Ambition.

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 Group 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 2022. The exposure that the Entity has to the risk has not materially heightened.

HSBC Group have assessed the impact of climate risk on their balance sheet and have concluded that there is no material impact on the Entity's financial statements for the year ended 31 December 2022. The impact on expected credit losses, classification and measurement of financial instruments and going concern was considered.

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 success in delivering our strategic priorities and proactively managing the regulatory and legislative environment depends on the development and retention of our leadership and high-performing employees. A highly competitive UK employment market, coupled with heightened inflationary pressures, will continue to test our ability to attract and retain talent. We remain focussed on supporting our employees during the cost of living crisis.

As we embed hybrid working in HSBC UK, we continue to concentrate on building and maintaining a high-performance culture and employee engagement in the new environment.

Data Risk

We use a large number of systems, applications and a growing quantity of data to support key business processes and operations. As a result, we need to reduce the risk of inaccurate data, unavailability of data or misuse of data; and we continue to focus on meeting the increasing external regulatory expectations and laws that cover data. 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.

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 our stakeholders helps us to deliver our strategy in line with our long term values and operate the business in a sustainable way. Our stakeholders are the people who work for us, bank with us, own us, regulate us, and live in the societies we serve and the planet we all inhabit. These human connections are complex and overlap. Many of our employees are customers and shareholders of our Group. We aim to serve, creating value for our customers and shareholders. We aim to do business responsibly, and thinking for the long term. This is key to delivering our strategy. Due to the nature of the relationship with them, M&S plc are considered to be a particularly key stakeholder.

We continue to evaluate our longer term strategy in light of the interest rate environment, considering the office footprint and supporting colleagues with a shift to a more location agnostic working model. We are also accelerating the roll-out of digital capabilities and functionality that helps customers to self-serve.

Employees

Our employees' health, well-being and engagement continues to be a focus for us. We have provided extensive support through the launch of a new Digital GP Service giving employees, their partners and dependants quick and easy access to primary care at the time of need.

We gave a one-off payment of £1,500 to more junior employees, to support them with rising cost of living pressures. In partnership with the Bank Workers Charity, HSBC have established the HSBC Support Fund to provide short-term financial support to current and former employees who find themselves in financial hardship.

A structured employee engagement 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.The HSBC Confidential Whistleblowing helpline enables employees to raise concerns in confidence and anonymously if they wish, without fear of retaliation and reprisal. Concerns are investigated thoroughly and independently and HSBC UK does not condone or tolerate any acts of retaliation against concern raisers.

Examples of how the Board has engaged with employees during 2022 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 2022.
- 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 how the Board has engaged with suppliers includes:

- Management reporting on Operational Resilience and Outsourcing risks to provide an understanding as to how the Entity monitors and manages the services provided by our third-party suppliers and how we work together with our suppliers to mitigate impacts to them and our customers in the challenging economic environment.

Customers

Customer needs are central to our business and must be understood so that we can appropriately support them. How we have served and supported our customers during 2022 is included throughout the Strategic Report. 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 2022, particularly in light of the challenging conditions created by the economic situation in the UK. Dedicated members of staff have been focussed on contacting customers who either raise 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 providing updates on 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 impacts of cost of living pressures and supporting vulnerable customers enabled the Board to assess whether the improvement of customer service and outcomes were prioritised appropriately.
- 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.

Shareholders

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 2022 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;
- Formal reporting on M&S Bank business by the Chairman at each Board meeting of HSBC UK.

M&S 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 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 and which is central to the M&S Bank's ability to meet its strategic ambition. During 2022, 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 and increasing digital functionality. During its discussions, the Board considered whether impacts to, and outcomes for, our stakeholders where 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 in 2021. 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

28 February 2023

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

A dividend payment of £27m in respect of the year ended 31 December 2021 was paid during the year.

The Directors recommend the payment of a dividend in respect of the year ended 31 December 2022 of £11m (£0.04p per share) (2021: £27m). Total distributions of £5m in respect of Additional Tier 1 capital were paid during 2022 (2021: £5m).

Significant events since the end of the financial year

A dividend in respect of the year ended 31 December 2022 of £11m 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 cost of living crisis.

Certain information that is required in the Report of the 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 has 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 of increasing inflation, the cost of living crisis and the war between Russia and Ukraine have had on our 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.

We strongly believe in providing equal opportunities for all employees. The employment of people with a disability is included in this commitment. The recruitment, training, development and promotion of people with a disability are based on the aptitudes and abilities of the individual. Should employees become disabled during their employments with us, efforts are made to continue their employment. Where necessary, we will provide appropriate training, facilities and reasonable equipment to ensure that barriers to work are removed for colleagues. Continuous work is done to ensure individual support is provided to make home office adjustments.

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 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 shareholders' equity. The Entity sets an internal limit above the regulatory threshold as a key control to mitigate the risk of capital management. 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. There were no changes to the Entity's approach to capital management during the year. 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 2022.

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 firms' capital base under CRD IV rules.
- Tier 2 comprises subordinated loans and excess of accounting provision over equivalent IRB expected loss subject to a cap of 0.6% of risk weighted assets.

Calculation of actual capital

	2022 £'000	2021 £'000
Tier 1 capital		
Shareholders' equity[1]	**390,606**	379,520
Deductions		
- Non performing exposures	**(82)**	0
- Adjustment for intangible assets	**(10,791)**	(202)
- IFRS 9 transitional add-back	**16,745**	9,726
Common equity tier 1 capital	**396,478**	389,044
Issue of additional tier 1 instrument (note 25)	**69,000**	69,000
Tier 1 capital	**465,478**	458,044
Tier 2 capital		
Total qualifying tier 2 capital before deductions		
- Collective impairment allowances	**7,289**	10,711
- Term subordinated debt (Note 23)	**95,000**	95,000
Tier 2 capital	**102,289**	105,711
Total regulatory capital	**567,767**	563,755
Risk-weighted assets (Unaudited)		
Credit and counterparty risk	**2,291,384**	1,952,623
Operational risk	**330,021**	391,275
Total	**2,621,405**	2,343,898
Capital ratios (%) (Unaudited)		
Common equity tier 1 ratio	**15.12**	16.60
Tier 1 ratio	**17.76**	19.54
Total capital ratio (Unaudited)	**21.66**	24.05

[1] *Includes reported profit for 2022 and foreseeable dividend proposed in respect of 2022.*

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 2022. 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 2022 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 4 to 5.

Independent auditors

PricewaterhouseCoopers LLP ('PwC') is the external auditor to the Entity. Following a tender process for the audit of HSBC Holdings plc and its subsidiaries that took place in 2022, it was recommended that PwC be reappointed as auditors for HSBC Group entities effective for periods ending on or after 1 January 2025. A resolution proposing the reappointment of PricewaterhouseCoopers LLP as auditor of the bank and giving authority to the Audit Committee to determine its remuneration will be submitted to the forthcoming Annual General Meeting ('AGM').

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 page 10 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 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 company and of the profit or loss of the company 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 accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for safeguarding the assets of the company 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 company's transactions and disclose with reasonable accuracy at any time the financial position of the company 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 company'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.

On behalf of the Board

Phillip Scott

P W Scott
Director
28 February 2023

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 2022 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 2022;
- the statement of comprehensive income for the year ended 31 December 2022;
- the balance sheet as at 31 December 2022;
- the statement of cash flows for the year ended 31 December 2022;
- the statement of changes in equity for the year ended 31 December 2022; and
- the notes to 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: £4,200,000 (2021: £5,000,000) based on 5% of 4-year average adjusted profit before tax.
- Performance materiality: £3,150,000 (2021: £3,750,000).

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.

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 key audit matters below are consistent with last year.

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

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. This included the assumptions made in determining forward looking economic scenarios and their probability weightings (specifically the central and downside scenarios given these have the most material impact on ECL). We also focussed on certain post model adjustments recognised by management, and redevelopment of the probability of default ('PD') models, which are important in the determination of ECL. The level of estimation uncertainty and judgement has remained high during 2022 as a result of the uncertain macroeconomic and geopolitical environment, high levels of inflation and a rising interest rate environment. This leads to uncertainty around judgements made in determining the severity and probability weighting of macroeconomic variable 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. Our discussions included: • The severity of macroeconomic scenarios, and their related probability weightings; • The redevelopment of ERM PD models; • Management judgemental adjustments and the nature and extent of analysis used to support those adjustments; and • The disclosures made in relation to ECL.

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 macroeconomic scenarios and their probability weightings, 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:

- 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;
- Independent model validation and monitoring; and
- The calculation and approval of the management judgemental adjustment made to modelled outcomes.

We involved our economic experts in assessing the significant assumptions made in determining the severity and probability weighting of macroeconomic forecasts, with particular focus on the downside and consensus central scenarios. These assessments considered the sensitivity of ECLs to variations in the severity and probability weighting of macroeconomic variables for different economic scenarios. We involved our modelling specialists in assessing the appropriateness of the significant assumptions and methodologies used for models. We independently reperformed the calculations for the models and material 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 substantive testing over:

- The compliance of ECL methodologies and assumptions with the requirements of IFRS 9;
- The assumptions and methodology underpinning the redeveloped retail PD models and independently replicated these models;
- The assumptions and methodology used for the macroeconmic -related adjustment, in conjunction with our risk modelling specialists;
- The appropriateness and application of the quantitative and qualitative criteria used to assess significant increases in credit risk; and
- A sample of critical data elements used in the year end ECL calculation and macroeconomic-related adjustment as at 31 December 2022.

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

Relevant references in the Annual Report and Financial Statements 2022

Note 1: Basis of preparation and significant accounting policies, Impairment of amortised cost financial assets, page 23 - 25.
Note 28 : Management of financial risk, Credit risk management, pages 38-48.

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

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. Rising interest rates have impacted the way that customers have used their credit cards. Although customer spending levels have increased in the year, the amount of interest bearing balances have remained flat, leading management to consider the changes in customer behaviour and where required, updating 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 on key areas of judgement including that change of the behavioural life assumption from 7 years to 6 years for certain portfolios. We also discussed the effect of rising interest rates on the EIR asset, and the impact on customer behaviour and future projections of spending levels.

How our audit addressed the key audit matter

We tested the design and operating effectiveness of 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 and approval of key assumptions, including monitoring of actual trends compared to forecast assumptions;
- Used our risk modelling specialists to rebuild the EIR model and independently run the year end input data through the model and comparing to management's output
- Utilised our risk modelling specialists to perform backtesting, by taking data from more mature cohorts, which have a comparable promotional period to newer portfolios, and comparing the expected behaviour to that actually experienced through our independent EIR model rebuild
- 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 2022

Note 1: Basis of preparation and significant accounting policies, Financial instruments measured at amortised cost, Pages 22 - 23.
Note 15: Loans and advances to customers, page 33.

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.

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 and the company's objectives and strategies. We updated our understanding of the internal control environment, including in relation to IT. Industry level factors were also considered, including applicable laws and regulations. Based on these initial audit planning procedures, we performed our risk assessment at the account balance and assertion level, considering the 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	£4,200,000 (2021: £5,000,000).
How we determined it	5% of 4-year average of 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 reflect the impact that Covid-19 and the volatility of the interest rate environment has had on the financial performance of the entity.

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% (2021: 75%) of overall materiality, amounting to £3,150,000 (2021: £3,750,000) 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 £210,000 (2021: £250,000) 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 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 2022 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 and the Prudential Regulation Authority's ('PRA') regulations, 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 and UK Tax legislation. 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 are related to the financial statements.
- Inspecting the minutes of the meetings of the Board of Directors and other key governance committees.
- 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

Following the recommendation of the Board of Directors, 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 8 years, covering the years ended 31 December 2015 to 31 December 2022.

Chris Shepherd.

Chris Shepherd (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
28 February 2023

Financial statements

Income statement for the year ended 31 December 2022

	Notes	2022 £'000	2021 £'000
Interest income	2	**181,087**	181,608
Interest expense	2	**(33,707)**	(18,162)
Net interest income		**147,380**	163,446
Fee and commission income		**90,060**	70,000
Fee and commission expense		**(22,811)**	(25,882)
Net fee income		**67,249**	44,118
Other operating income	3	**2,683**	527
Other operating expense	4	**–**	(48,371)
Net operating income before change in expected credit losses and other credit impairment charges		**217,312**	159,720
Change in expected credit losses and other credit impairment charges	2	**(61,295)**	97,747
Net operating income		**156,017**	257,467
Employee compensation and benefits	5	**(35,802)**	(43,500)
General and administrative expenses	2	**(79,658)**	(93,334)
Depreciation of property, plant and equipment	16	**(301)**	(978)
Amortisation of intangible assets	17	**(310)**	(791)
Depreciation of right-of-use assets	27	**(1,933)**	(3,069)
Total operating expenses		**(118,004)**	(141,672)
Operating profit		**38,013**	115,795
Profit before tax		**38,013**	115,795
Tax expense	9	**(11,688)**	(22,233)
Profit for the year		**26,325**	93,562

Profit after tax ('PAT') arises from:

	2022 £'000	2021 £'000
Continued Operations (PAT £000's)	**26,325**	100,098
Discontinued Operations (PAT £000's)[1]	**–**	(6,536)

[1] Discontinued operations are shown in Note 13.

Statement of comprehensive income for the year ended 31 December 2022

	2022 £'000	2021 £'000
Profit for the year	**26,325**	93,562
Total comprehensive income for the year	**26,325**	93,562

There has been no comprehensive income or expense other than the profit for the year as shown above (2021: nil). This includes results attributable to the discontinued operations.

Marks and Spencer Financial Services Plc

Balance sheet at 31 December 2022
Registration No: 1772585

	Notes	2022 £'000	2021 £'000
Assets			
Cash and balances at central banks[1]		**5,090**	5,013
Items in the course of collection from other banks		**51,525**	9,028
Loans and advances to banks	*14*	**869,089**	908,547
Loans and advances to customers	*15*	**3,383,735**	3,147,992
Prepayments and accrued income		**2,429**	3,343
Other assets	*18*	**122,751**	102,389
Property, plant and equipment	*16*	**582**	679
Right-of-use assets	*27*	**13,028**	12,175
Intangible assets	*17*	**10,791**	3,659
Deferred tax assets	*10*	**10,066**	12,756
Total assets		**4,469,086**	4,205,581
Liabilities and equity			
Liabilities			
Deposits by banks	*19*	**2,858,147**	2,400,000
Customer accounts	*20*	**887,971**	1,085,433
Items in the course of transmission to other banks		**3,810**	1,599
Accruals, deferred income and other liabilities	*21*	**107,912**	81,503
Current tax liabilities		**7,858**	12,470
Provisions	*22*	**36,403**	52,690
Subordinated liabilities	*23*	**96,380**	96,367
Total liabilities		**3,998,481**	3,730,062
Equity			
Called up share capital	*25*	**260,000**	260,000
Other equity instruments	*25*	**69,000**	69,000
Retained earnings		**141,605**	146,519
Total equity		**470,605**	475,519
Total liabilities and equity		**4,469,086**	4,205,581

1. *At 31 December 2022 £5.1m (2021: £4.3m) was not available for use by the Entity as it relates to mandatory deposits at central banks.*

The accompanying notes on pages 21 to 51 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 28 February 2023 and signed on its behalf by:

Phillip Scott

P W Scott
Director

Statement of cash flows for the year ended 31 December 2022

	Notes	2022 £'000	2021 £'000
Cash flows from operating activities			
Profit before tax		**38,013**	115,795
Adjustments for:			
Non-cash items included in profit before tax	11	**15,787**	(175,023)
Change in operating assets[1]	11	**(354,722)**	664,424
Change in operating liabilities[2]	11	**(170,561)**	(1,082,413)
Tax (paid)/credit received		**(13,322)**	708
Net cash used in operating activities		**(484,805)**	(476,509)
Cash flows from investing activities			
Purchase of property, plant and equipment		**(204)**	(176)
Purchase of intangible assets		**(7,442)**	(3,443)
Adjustment of leases		**(2,787)**	2,137
Net cash used in investing activities		**(10,433)**	(1,482)
Cash flows from financing activities			
Proceeds from Borrowings		**210,000**	149,967
Dividends		**(27,000)**	–
Distribution on other equity instruments (AT1)		**(5,003)**	(5,003)
Net cash generated from financing activities		**177,997**	144,964
Net decrease in cash and cash equivalents		**(317,241)**	(333,027)
Cash and cash equivalents brought forward[1]		**466,988**	800,015
Cash and cash equivalents carried forward[3]	11	**149,747**	466,988

1. *Operating assets movement includes £265m change in Loans and advances to customers and a £70m change in Loans and advances to banks.*
2. *Operating liabilities movement includes £68m Cash ISA balance, £35m Everyday Saver Customer balance, and £97m Fixed rate savings balance.*
3. *At 31 December 2022 £5.1m (2021: £4.3m) 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 2022

	Called up share capital £'000	Other equity instruments £'000	Retained earnings £'000	Total equity £'000
At 1 Jan 2022	**260,000**	**69,000**	**146,519**	**475,519**
Profit for the year	–	–	26,325	26,325
Dividends paid	–	–	(27,000)	(27,000)
Distribution on other equity instrument	–	–	(5,003)	(5,003)
Net impact of equity-settled share-based payments	–	–	764	764
At 31 Dec 2022	**260,000**	**69,000**	**141,605**	**470,605**

	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

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 and with the requirements of the Companies Act 2006, as applicable to companies reporting under those standards. There were no unendorsed standards effective for the year ended 31 December 2022 affecting the Entity's financial statements.

Standards adopted during the year ended 31 December 2022

There were no new accounting standards or interpretations that had a significant effect on the Entity in 2022. Accounting policies have been consistently applied.

(b) Future accounting developments

Minor amendments to IFRSs

The IASB has not published any minor amendments effective from 1 January 2022 that are applicable to the Entity. However, the IASB has published a number of minor amendments to IFRSs that are effective from 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'

IFRS17 'Insurance Contracts' was issued in May 2017, it has been adopted for use in the UK but 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 Accounts 2022 as follows:

- disclosures concerning the nature and extent of risks relating to financial instruments are included in the Management of Financial Risk note on page 38; and
- capital disclosures are included in the 'Report of the Directors: Capital Management' on Pages 8 to 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 has 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 of increasing inflation, the cost of living crisis and the war between Russia and Ukraine have had on our 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 2022 the Entity did not hold any financial guarantee contracts (2021: nil).

(b) Income and expense

Interest income and expense

Interest income and expense for all financial instruments, are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest rate ('EIR') method.

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 significant act is recognised as revenue when the act is completed for example travel money income; and
- Income earned from the provision of services is recognised as revenue as the services are provided (for example, asset management services).

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 £53.1m (2021: £59.6m) within loans and advances to customers at 31 December 2022.

Judgements	Estimates
• The estimated life is reviewed annually and management has assessed seven years to be the most appropriate life for front book plans and six years for back book plans. The impact of reducing the estimated life by 1 year (front book to six years and back book to five years) would be a reduction in the EIR asset of £10.7m (2021: £12.0m). • 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 total asset value by £2.6m (2021: £3.0m); and • similarly, a decrease in the assumed interest yield of 5% would decrease the total asset value by £7.3m (2021: £6.7m). (The interest yield assumption is the amount of interest receivable over the life of the account.)

(d) Impairment of amortised cost financial assets

Expected credit losses ('ECL') are recognised for loans and advances to banks and customers. At initial recognition, an allowance (or provision in the case of some loan commitments) 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, an 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 which 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'. Purchased or originated credit impaired financial assets ('POCI') are treated differently, as set out below.

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 that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition, or 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.

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.

Forbearance

Loans are identified as forborne and classified as either performing or non-performing when we modify the contractual terms due to financial difficulty of the borrower. Non-performing forborne loans are stage 3 and classified as non-performing until they meet the cure criteria, as specified by applicable credit risk policy (for example, when the loan is no longer in default and no other indicators of default have been present for at least 12 months). Any amount written off as a result of any modification of contractual terms upon entering forbearance would not be reversed.

In 2022, we adopted the European Banking Authority ('EBA') Guidelines on the application of definition of default for our retail portfolios, which affects credit risk policies and our reporting in respect of the status of loans as credit impaired principally due to forbearance (or curing thereof). The effect of adoption was immaterial both quantitatively to ECL and for staging. Further details are provided on page 47.

Performing forborne loans are initially stage 2 and remain classified as forborne until they meet applicable cure criteria (for example, they continue to not be in default and no other indicators of default are present for a period of at least 24 months). At this point, the loan is either stage 1 or stage 2 as determined 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).

A forborne loan 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 forborne loan is a substantially different financial instrument. Any new loans that arise following derecognition events in these circumstances would generally be classified as POCI and will continue to be disclosed as forborne.

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. However, 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 rRetail portfolios, default risk is assessed using a reporting date 12-month PD derived from credit scores, which incorporate 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 homogenous 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 therefore identifies loans with a PD higher than would be expected from loans that are performing as originally expected and higher from that which would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs. As additional data becomes available, the retail transfer criteria approach continues to be refined to utilise a more relative approach for certain portfolios that have not had a significant impact on the levels of ECL, but has resulted in a higher volume of lending balances being classified as stage 2.

As additional data becomes available, the retail transfer criteria approach continues to be refined to utilise a more relative approach for certain portfolios. These enhancements leverage the increase in origination related data in the assessment of significant increases in credit risk by comparing remaining lifetime probability of default to the comparable remaining term lifetime probability of default at origination based on portfolio-specific origination segments. These enhancements have not had a significant impact on the overall ECL for these portfolios in 2022.

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 (other than POCI) 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. In the case of non-performing forborne loans, such financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment and meet the curing criteria as described above.

Measurement of ECL

The assessment of credit risk and the estimation of ECL are unbiased and probability-weighted, and incorporate all available information which 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 and considers other factors such as climate-related risks.

In general, HSBC calculates ECL using three main components: a probability of default ('PD'), 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 makes use of the Basel II IRB framework where possible, with recalibration to meet the differing IFRS 9 requirements as 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	• 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). • No floors • Discounted using the original effective interest rate of the loan
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

Expected credit loss 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. 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 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 its 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. The detailed methodology is disclosed in 'Measurement uncertainty and sensitivity analysis of ECL estimates' on page 39.

Critical accounting estimates and judgements

The calculation of the Entity's ECL under IFRS 9 requires the Entity 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 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 model and data limitations and deficiencies.	• The measurement uncertainty and sensitivity analysis of ECL estimates on page 39 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

HSBC group operates a number of pension schemes including defined benefit, defined contribution and post-employment benefit schemes.

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 as 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 in which the assets will be realised or the liabilities settled.

In assessing the probability and sufficiency of future taxable profit, we consider the availability of evidence to support the recognition of deferred tax assets, taking into account the inherent risks in long-term forecasting, including climate change-related, and drivers of recent history of tax losses where applicable. We also consider the future reversal of existing taxable temporary differences and tax planning strategies, including corporate reorganisations.

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 depreciated on a straight line basis over their useful lives, which are 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 that have a finite useful life are stated at cost less amortisation and accumulated impairment losses and are amortised over their estimated useful lives.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. 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, 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 where an indicator of impairment is identified (as per IAS 36).

(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

Operating Profit is stated after the following items:

	2022 £'000	2021 £'000
Interest income		
Loans and advances to customers	**178,922**	180,012
Interest received from group undertakings	**2,165**	1,596
Total interest income	**181,087**	181,608
Interest expense		
Customer accounts	**4,649**	3,987
Interest paid to group undertakings	**28,727**	13,958
Other interest paid	**331**	217
Total interest expense	**33,707**	18,162
Fee and commission income		
Credit Card income	**28,260**	20,011
Club Rewards income	**20,363**	21,066
Travel Money income	**25,010**	6,426
Insurance income	**13,154**	17,597
Other product income/(expense)	**(32)**	1,329
Product income	**86,755**	66,429
Other income	**3,305**	3,571
Total fee and commission income	**90,060**	70,000
Fee and commission expense		
Product acquisition and retention costs	**4,849**	9,584
Other fees paid	**17,962**	16,298
Total fee and commission expense	**22,811**	25,882
Change in expected credit losses and other credit impairment charges		
Change in expected credit losses and other credit impairment charges	**61,295**	(97,747)
Total change in expected credit losses and other credit impairment charges	**61,295**	(97,747)
General and administrative expenses		
Remediation costs	**(2,999)**	9,524
Expenses payable to group undertakings	**45,126**	44,201
Other expenses	**37,531**	39,609
Total general and administrative expenses	**79,658**	93,334

3. Other operating income

	2022 £'000	2021 £'000
Sublease rental income	**–**	71
Gains on Financial Instruments	**455**	456
M&S plc Profit Share (Note 18)	**2,228**	–
Total other operating income	**2,683**	527

4. Other operating expense

	2022 £'000	2021 £'000
M&S plc Profit Share (Note 18)	**–**	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 income in the year (2021: expense) due to business performance. See Note 18 Other Assets for further details.

5. Employee compensation and benefits

Total employee compensation

	2022 £'000	2021 £'000
Wages and salaries including share-based payments	**29,021**	35,773
Social security costs	**2,937**	3,125
Post-employment benefits	**3,844**	4,602
Year ended 31 Dec	**35,802**	43,500

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

Average number of persons employed by the Entity during the year

	2022	2021
Head Office Administration	**450**	574
Selling and Distribution	**437**	537
Year ended 31 Dec	**887**	1,111

The reduction in headcount in 2022 is a result of transformation activity and exiting the branch network in 2021.

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 2022, 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:

	2022 £'000	2021 £'000
Savings-related and other share award option plans	**466**	669
Year ended 31 Dec	**466**	669

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 in HSBC Holdings Plc.. • 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% (2021: 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 2022	**1,135**	**5.21**
Granted during the year	**332**	**4.24**
Exercised during the year	**(165)**	**4.76**
Expired during the year	**(219)**	**3.27**
Outstanding at 31 Dec 2022	**1,083**	**5.37**
Weighted average remaining contractual life (years)		**2**

	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

1 The weighted average exercise price (WAEP) of share options outstanding, which is calculated when transactions are contracted, was £4.07 (2021: £3.96).

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:

	2022 £'000	2021 £'000
Fees [1]	**90**	90
Salaries and other emoluments [2]	**389**	387
Pension contributions	**26**	25
Annual incentives [3]	**180**	99
Year ended 31 Dec	**685**	601

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 2022 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £36,000 in cash, £54,000 in deferred cash (vesting annually over a five year period), £36,000 in immediate shares and £54,000 in deferred shares (vesting annually over a five year period). Vested shares are subject to a retention period of up to one year.*
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 five year period),£33,000 in immediate shares and £18,000 in deferred shares (vesting annually over a five year period). Vested shares are subject to a retention period of up to one year.

No Directors exercised share options over HSBC Holdings plc ordinary shares during the year (2021: two).

Awards were made to two Directors under long-term incentive plans in respect of qualifying services rendered in 2022 (2021: two Directors). During 2022, two Directors received shares in respect of awards under long-term incentive plans that vested during the year (2021: 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:

	2022 £'000	2021 £'000
Salaries and other emoluments	**247**	246
Annual incentives [1]	**117**	68
Year ended 31 Dec	**364**	314

1 *Awards made to the highest paid Director in respect of 2022 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £23,400 in cash, £35,100 in deferred cash (vesting annually over a five year period), £23,400 in immediate shares and £35,100 in deferred shares (vesting annually over a five year period). Vested shares are subject to a retention period of up to one year.*
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 five year period), £21,600 in immediate shares and £13,500 in deferred shares (vesting annually over a five year period). Vested shares are subject to a retention period of up to one year.

The highest paid Director received 10,009 (2021: 3,273) 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 (2021: none) share options over HSBC Holdings plc ordinary shares during the year.

Pension contributions of £3,600 (2021: £3,600) were made by the Entity in respect of services by the highest paid Director during the year.

8. Auditors' remuneration

	2022 £'000	2021 £'000
Audit fees for statutory audit		
- Fees relating to current year	**605**	540
- Other audit-related services pursuant to regulation	**48**	45
- Other assurance services	**25**	—
Year ended 31 Dec	**678**	585

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

9. Tax expense

Tax expense

	2022 £'000	2021 £'000
Current tax		
UK corporation tax		
- For this year	**7,889**	24,573
- Adjustments in respect of prior years	**852**	(2,026)
Total current tax	**8,741**	22,547
Deferred tax		
- For this year	**1,542**	1,401
- Effects of changes in tax rates	**2,036**	(2,175)
- Adjustments in respect of prior years	**(631)**	460
Total deferred tax	**2,947**	(314)
Year ended 31 Dec	**11,688**	22,233
Equity items		
- Current tax	**30**	5
- Deferred tax - current year	**258**	(248)
- Deferred tax - prior year	**—**	(14)
Total equity items	**288**	(257)

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 (2021: 27%).

In addition to the amount charged to the income statement, the aggregate amount of current and deferred tax relating to items that are debited directly to equity is £288k.

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:

	2022 £'000	(%)	2021 £'000	(%)
Profit before tax	**38,013**		115,795	
Tax at 19% (2021: 19%)	**7,221**	**19.00**	22,001	19.00
Adjustments in respect of prior years	**222**	**0.58**	(1,566)	(1.35)
Permanent disallowables	**518**	**1.36**	(3,939)	(3.40)
Impact due to changes in tax rates	**2,036**	**5.36**	(2,175)	(1.88)
Deductions for AT1 coupon payments	**(1,351)**	**(3.55)**	(1,351)	(1.17)
Banking surcharge	**3,042**	**8.00**	9,263	8.00
Year ended 31 Dec profit/(loss)	**11,688**	**30.75**	22,233	19.20

The effective tax rate for the year was 30.75% (2021: 19.2%). The effective tax rate is increased by 5.36% by a charge arising from the remeasurement of the Entity's deferred tax balances following the substantive enactment of legislation to reduce the UK banking surcharge rate from 8% to 3%, with effect from 1 April 2023. The prior year effective tax rate of 19.2% was lower than the UK rate of corporation tax for banking entities of 27% following enactment of legislation to increase the main rate of UK corporation tax from 19% to 25% from 1 April 2023. This had decreased the prior year effective tax rate by 1.88%.

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 2022	**4,420**	**351**	**102**	**7,883**	**12,756**
Income statement (charge)/credit	**(1,277)**	**54**	**(35)**	**(2,320)**	**(3,578)**
Equity statement credit	**—**	**258**	**—**	**—**	**258**
Prior year adjustments	**500**	**—**	**130**	**—**	**630**
At 31 Dec 2022	**3,643**	**663**	**197**	**5,563**	**10,066**

	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 (charge)/credit	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

Management has assessed the likely availability of future taxable profits against which to recover the deferred tax assets of the Entity, 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 before tax to net cash flow from operating activities

	2022 £'000	2021 £'000
Profit before tax	**38,013**	115,795
Non-cash items included in profit and loss		
Depreciation, amortisation and impairment	**2,544**	4,835
Credit-related impairment losses	**29,530**	(140,189)
Adjustment to provisions	**(16,287)**	(39,671)
	15,787	(175,025)
Change in operating assets		
Change in prepayments and accrued income	**913**	(472)
Change in loans and advances to customers[1]	**(265,273)**	231,374
Change in other assets	**(20,362)**	67,522
Change in Loans and advances to banks	**(70,000)**	366,000
	(354,722)	664,424
Change in operating liabilities		
Change in accruals and deferred income	**(3,097)**	1,610
Change in customer accounts[2]	**(197,463)**	(1,093,157)
Change in other liabilities	**29,999**	9,134
	(170,561)	(1,082,413)
Cash and cash equivalents comprise		
Cash and balances at central banks[3]	**5,090**	5,013
Items in the course of collection from other banks	**51,525**	9,028
Loans and advances to banks of one month or less	**490,089**	599,546
Deposit by banks of one month or less	**(393,147)**	(145,000)
Less: Items in the course of transmission to other banks	**(3,810)**	(1,599)
	149,747	466,988

1. *Operating assets movement includes of £265m change in Loans and advances to customers and a £70m change in Loans and advances to banks.*
2. *Operating liabilities movement includes £68m Cash ISA balance, £35m Everyday Saver Customer balance, and £97m Fixed rate savings balance.*
3. *At 31 December 2022 £5.1m (2021: £4.3m) 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

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	
		Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000	£'000
At 31 Dec 2022					
Assets					
Loans and advances to banks	**869,089**	–	**869,089**	–	**869,089**
Loans and advances to customers	**3,383,735**	–	–	**3,361,772**	**3,361,772**
Liabilities					
Deposits by banks	**2,858,147**	–	**2,858,147**	–	**2,858,147**
Customer accounts	**887,971**	–	**887,971**	–	**887,971**
Subordinated liabilities	**96,380**	–	**87,475**	–	**87,475**
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

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

To determine the fair value of loans and advances to banks and customers, loans are segregated, as far as possible, into portfolios of similar characteristics. Fair values are based on observable market transactions, when available. When they are unavailable, fair values are estimated using valuation models incorporating a range of input assumptions. These assumptions may include: forward-looking discounted cash flow models, taking account of expected customer prepayment rates, using assumptions that the Entity believes are consistent with those that would be used by market participants in valuing such loans; and new business rates estimates for similar loans.

The fair value of loans reflects expected credit losses at the balance sheet date and the fair value effect of repricing between origination and the balance sheet date. For credit impaired loans, fair value is estimated by discounting the future cash flows over the time period they are expected to be recovered.

Deposits by banks and customer accounts

The fair values of on-demand deposits are approximated by their carrying value. For deposits with longer-term maturities, fair values are estimated using discounted cash flows, applying current rates offered for deposits of similar remaining maturities.

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, from 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

There are no discontinued operations in 2022.

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.

Income Statement

	2022 £'000	2021 £'000
Interest income	–	6,187
Interest expense	–	(2,002)
Net interest income	–	4,185
Fee and commission income	–	823
Fee and commission expense	–	(9,313)
Net fee expense	–	(8,490)
Other operating income	–	3,340
Net operating expense before change in expected credit losses and other credit impairment charges	–	(965)
Change in expected credit losses and other credit impairment charges	–	650
Net operating expenses	–	(315)
Employee compensation and benefits	–	(5,791)
General and administrative expenses	–	(1,983)
Total operating expenses	–	(7,774)
Operating Loss	–	(8,089)
Loss before tax	–	(8,089)
Tax credit	–	1,553
Loss for the year	–	(6,536)

Cash flows relating to the 2021 discontinued operations are shown in the table below:

Cash Flow Statement

	2022 £'000	2021 £'000
Cash flows from operating assets	–	227,525
Cash flows from operating liabilities	–	(769,900)
Cash flows from loans and advances to banks[1]	–	769,900
Cash flows from cash and cash equivalents	–	(227,525)
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.*

2021 figures include 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

	2022 £'000	2021 £'000
Loans and advances held with parent	**869,000**	908,407
Nostro balances with parent and fellow subsidiaries	**89**	140
At 31 Dec	**869,089**	908,547

Amounts due from group undertakings are unsecured, interest bearing and have fixed dates of repayment which range from 18 January 2023 to 11 March 2026. 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

	2022 £'000	2021 £'000
Gross loans and advances to customers	**3,513,522**	3,248,247
Expected credit loss provision (Note 28)	**(129,787)**	(100,255)
At 31 Dec	**3,383,735**	3,147,992

Loans and advances to customers by product

	2022		2021	
	Gross loans and advances to customers £'000	**Gross loan by industry as % of total gross loans %**	Gross loans and advances to customers £'000	Gross loan by industry as % of total gross loans %
Cards	**2,263,538**	**64 %**	2,052,901	63 %
Consumer Loans	**1,240,826**	**35 %**	1,184,152	36 %
Other Personal lending	**9,158**	**— %**	11,194	— %
At 31 Dec	**3,513,522**	**100 %**	3,248,247	100 %
Impaired loans	**60,941**		64,649	
as a % of total	**1.7**		2.0	

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 £53.1m within loans and advances to customers as at 31 December 2022 (31 December 2021: £59.6m).

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

- the estimated life of the customer account (currently 7 years for front book and 6 years for back book);
- future balance forecasts; and
- future interest forecasts.

The estimated life is reviewed annually and management have assessed seven years to be the most appropriate life for front book plans and six years for back book plans. The impact of reducing the estimated life by 1 year (front book to 6 years and back book to 5 years) would be a reduction in the EIR asset of £10.7m (2021: £12.0m).

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 has 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 2022 asset value: £47.0m), 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 £2.3m. A 5% decrease in the assumed interest yield would decrease the asset value by £6.8m.

In the case of back book plans (31 December 2022 asset value: £5.9m), 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 £0.3m. A 5% decrease in the assumed interest yield would decrease the asset value by £0.5m.

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

16. Property, plant and equipment

	Equipment, fixtures and fittings	
	2022 £'000	2021 £'000
Cost		
At 1 Jan	**51,488**	51,312
Additions	**204**	176
Disposals	**(30,886)**	—
As at 31 Dec	**20,806**	51,488
Accumulated depreciation		
At 1 Jan	**50,809**	49,832
Charge for the year	**301**	977
Disposals	**(30,886)**	—
As at 31 Dec	**20,224**	50,809
Net book value		
At 1 Jan	**679**	1,480
As at 31 Dec	**582**	679

£31m of fully depreciated assets were disposed of during the year.

17. Intangible assets

	Software development costs	
	2022	2021
	£'000	£'000
Cost		
At 1 Jan	**60,093**	56,650
Additions	**7,442**	3,443
Disposals	**(1,892)**	–
As at 31 Dec	**65,643**	60,093
Accumulated amortisation		
At 1 Jan	**56,434**	55,643
Charge for the year	**310**	791
Disposals	**(1,892)**	–
As at 31 Dec	**54,852**	56,434
Net book value		
At 1 Jan	**3,659**	1,007
As at 31 Dec	**10,791**	3,659

Included within the intangible assets is internally generated software with a net carrying value of £10.8m (2021: £3.7m). During the year, *capitalisation of internally generated software is £4.1m (2021: £nil) and amortisation is £0.4m (2021 £nil). Additions in software* development cost in 2022 relate to Sparks Pay intangibles recognised in the year.

18. Other assets

	2022	2021
	£'000	£'000
Amounts due from group undertakings	**34,575**	18,570
Profit Share due from M&S plc	**70,779**	70,551
Other items due from M&S plc	**8,275**	6,916
Other assets	**9,122**	6,352
At 31 Dec	**122,751**	102,389

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 2023-2028. These cash flows are sufficient enough to cover the value of the asset indicating that there is no impairment requirement.

19. Deposits by banks

	2022	2021
	£'000	£'000
Amounts due from group undertakings	**2,858,147**	2,400,000
At 31 Dec	**2,858,147**	2,400,000

Amounts due to group undertakings are unsecured, interest bearing, and have fixed dates of repayment which range from 18 January 2023 to 30 November 2027.

20. Customer accounts

	2022	2021
	£'000	£'000
Credit balances on unsecured loans and advances	**10,315**	10,672
Customer deposits	**877,656**	1,074,761
At 31 Dec	**887,971**	1,085,433

Customer savings deposits have both fixed and variable interest rates and are repayable on demand. Customer deposits with variable rates totalled £647m (2021: £747m). Customer deposits with fixed rates totalled £231m (2021: £327m).

21. Accruals, deferred income and other liabilities

	2022 £'000	2021 £'000
Accruals and deferred income	**13,125**	16,221
Amounts owed to intermediate parent undertaking	**10,302**	2,955
Amounts owed to other group companies	**14,345**	11,580
Items in the course of settlement	**51,776**	33,096
Lease liabilities	**13,582**	12,540
Other liabilities	**4,782**	5,111
At 31 Dec	**107,912**	81,503

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	Collections related remediation and provisions £'000	NOSIA Provision £'000	Customer redress provision £'000	Fraud provision £'000	ECL on undrawn commitments £'000	Total £'000
At 1 Jan 2022	**1,237**	**10,444**	**108**	**38,956**	**444**	**1,501**	**52,690**
Increase/(Decrease) in provision	**468**	**3,183**				**(109)**	**3,542**
Provision utilised	**(1,063)**	**(8,683)**	**(7)**	**(5,227)**	**(113)**	**–**	**(15,093)**
Provision released	**(174)**			**(4,382)**	**(180)**	**–**	**(4,736)**
At 31 Dec 2022	**468**	**4,944**	**101**	**29,347**	**151**	**1,392**	**36,403**
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

Restructuring provision

A provision of £0.5m (2021: £1.2m) 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

At 31 December 2022, a provision of £5m (2021: £10m) was held relating to the estimated liability for redress payable to customers following a review of historical collections and recoveries practices. During 2022, redress payments and incurred operating costs totalled £8m and a net provision increase was made of £3m. Provision increases relate to a population of charged-off personal loans that settled within term requiring a retrospective refund of interest charged and necessary compensation (£2m), and expected secondary contact requirements for unclaimed redress payments (£1m).

Customer redress - PPI

At 31 December 2022, £29m (2021: £39m) 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. Payments totalling £5m were made during 2022, and additional provision reductions were made of £4m primarily as a result of lower than expected litigation claim 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 remaining 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 £3m.

b. A 20% increase/decrease in the volume of future claims received via litigation would increase/decrease the redress provision by approximately £3m.

c. A 20% increase/decrease in handling cost per court claim would increase/decrease the redress provision by approximately £3m.

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

	2022 £'000	2021 £'000
£9m variable/fixed rate notes maturing June 2029 [1]	**9,006**	9,002
£7m variable/fixed rate notes maturing December 2029 [2]	**7,013**	7,004
£79m fixed rate notes maturing March 2031 [3]	**80,361**	80,361
At 31 Dec	**96,380**	96,367

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).

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 2022 and 31 December 2021.

[1] *Lender is HSBC UK Bank plc. The interest rate is SONIA T-5 basis + 222.40 bps.*
[2] *Lender is HSBC UK Bank plc. The interest rate is SONIA T-5 basis + 173.69 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 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	**5,090**	–	–	–	–	–	**5,090**
Items in the course of collection from other banks	**51,525**	–	–	–	–	–	**51,525**
Loans and advances to banks	**89**	**510,000**	**165,000**	**194,000**	–	–	**869,089**
Loans and advances to customers	**6,169**	**2,307,833**	**291,538**	**748,649**	**29,546**	–	**3,383,735**
Prepayments and accrued income	–	**2,429**	–	–	–	–	**2,429**
Other assets	–	**51,972**	–	–	–	**70,779**	**122,751**
Right-of-use assets	–	–	–	–	**13,028**	–	**13,028**
Non-financial assets	–	–	–	–	–	**21,439**	**21,439**
At 31 Dec 2022	**62,873**	**2,872,234**	**456,538**	**942,649**	**42,574**	**92,218**	**4,469,086**
Liabilities							
Deposits by banks	**223,147**	**540,000**	**810,000**	**1,285,000**	–	–	**2,858,147**
Customer accounts	**887,971**	–	–	–	–	–	**887,971**
Items in the course of transmission to other banks	**3,810**	–	–	–	–	–	**3,810**
Accruals and other financial liabilities	–	**463**	**1,402**	**7,888**	**3,829**	**94,330**	**107,912**
Subordinated liabilities	–	**1,380**	–	–	**95,000**	–	**96,380**
Provisions	–	**4,136**	**15,928**	**16,339**	–	–	**36,403**
Non-financial liabilities	–	**7,858**	–	–	–	–	**7,858**
At 31 Dec 2022	**1,114,928**	**553,837**	**827,330**	**1,309,227**	**98,829**	**94,330**	**3,998,481**

	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

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.

	2022		2021	
	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 2022.

Other equity instruments

Marks and Spencer Financial Services plc additional tier 1 instruments.

	2022	2021
	£'000	£'000
£40m Undated Subordinated Additional Tier 1 instrument issued 2016 (callable March 2023) [1]	**40,000**	40,000
£20m Undated Subordinated Additional Tier 1 instrument issued 2017 (callable December 2023) [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. The interest rate is fixed at 8.5625%.*
[2] *Holder is HSBC Holdings Limited. 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 2022.

26. Contingent liabilities, contractual commitments and guarantees

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

	2022	2021
	£'000	£'000
	Contract amount	Contract amount
Commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend	**10,532,079**	10,665,948
At 31 Dec	**10,532,079**	10,665,948

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	
	2022	2021
	£'000	£'000
Cost		
At 1 Jan	**18,497**	24,628
Lease modifications[1]	**2,787**	334
Disposals[1]	**—**	(6,465)
As at 31 Dec	**21,284**	18,497
Accumulated depreciation		
At 1 Jan	**6,322**	7,248
Charge for the year	**1,934**	3,069
Disposals	**—**	(3,995)
As at 31 Dec	**8,256**	6,322
Net book value		
At 1 Jan	**12,175**	17,380
As at 31 Dec	**13,028**	12,175

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 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 2022

For our retail portfolios, we adopted the EBA 'Guidelines on the application of definition of default' during 2022. Adoption of these guidelines did not have a material impact on our portfolios and comparative disclosures have not been restated.

More detailed analysis of ECL can be found on pages 41 to 48.

A summary of our current policies and practices regarding credit risk is set out on page 23.

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 increased from £102m at 1 January 2022 to £131m at 31 December 2022. The IFRS 9 allowance for ECL at 31 December 2022 comprises of £130m in respect of assets held at amortised cost and £1m in respect of loan commitments. More detailed analysis of ECL can be found on pages 41-48.

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

	2022		2021	
	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	**3,513,522**	**(129,787)**	3,248,248	(100,256)
Loans and advances to banks at amortised cost	**869,089**	**—**	908,547	(1)
Other financial assets at amortised cost[2]	**110,690**	**—**	49,067	—
Total gross carrying amount on balance sheet	**4,493,301**	**(129,787)**	4,205,862	(100,257)
Loans and other credit related commitments	**10,532,079**	**(1,392)**	10,665,948	(1,501)
Total nominal amount off-balance sheet[3]	**10,532,079**	**(1,392)**	10,665,948	(1,501)
At 31 Dec	**15,025,380**	**(131,179)**	14,871,810	(101,758)

1 *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.*

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: These financial assets are 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 on these financial assets since initial recognition for which a lifetime ECL is recognised.
- Stage 3: There is objective evidence of impairment and the financial assets 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	**2,656,828**	**795,753**	**60,941**	**(12,378)**	**(97,381)**	**(20,028)**	**–**	**(12)**	**(33)**
Loans and advances to banks at amortised cost	**869,089**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Other financial assets measured at amortised cost[1]	**110,690**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Loan and other credit-related commitments	**10,448,238**	**40,976**	**42,865**	**(1,170)**	**(222)**	**–**	**–**	**–**	**–**
At 31 Dec 2022	**14,084,845**	**836,729**	**103,806**	**(13,548)**	**(97,603)**	**(20,028)**	**–**	**(12)**	**(19)**
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)

[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 by those less than 30 days and greater than 30 DPD and therefore presents those financial assets classified as stage 2 due to ageing (30 DPD) and those identified at an earlier stage (less than 30 DPD).

Stage 2 days past due analysis at 31 December 2022

	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 Days past due	30 and > Days past due		Up-to-date	1 to 29 Days past due	30 and > Days past due		Up-to-date	1 to 29 Days past due	30 and > Days past due
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	%	%	%	%
Loans and advances to customers at amortised cost as at 31 Dec 2022	**795,753**	**770,970**	**14,811**	**9,972**	**(97,381)**	**(85,468)**	**(5,631)**	**(6,282)**	**(12.2)**	**(11.1)**	**(38.0)**	**(63.0)**

The days past due amounts presented above are on a contractual basis.

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*
		Up-to-date	1 to 29 Days past due	30 and > Days past due		Up-to-date	1 to 29 Days past due	30 and > Days past due		Up-to-date	1 to 29 Days past due	30 and > Days past due
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	%	£'000	%	%
Loans and advances to customers at amortised cost as at 31 Dec 2021	292,652	270,954	13,786	7,912	(59,270)	(48,952)	(4,926)	(5,392)	20.3	18.1	35.7	68.1

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 area, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions. The Entity uses a number of controls and measures to minimise undue concentration of exposure in the Entity's portfolios across 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 2022.

Loans and advances to customers and banks held at amortised cost

The table on page 45 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 situation 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

Amid a deterioration in the economic and geopolitical environment, management judgements and estimates continued to be subject to a high degree of uncertainty in relation to assessing economic scenarios for impairment allowances in 2022.

Inflation, economic contraction and high interest rates combined with an unstable geopolitical environment and the effects of a global supply chain disruption have contributed to elevated degrees of uncertainty during the year.

At 31 December 2022, as a result of this uncertainty, additional stage 1 and 2 allowances have been recognised while management judgements and estimates continue to reflect a degree of caution both in the selection of economic scenarios and their weightings, and in the use of management judgemental adjustments, described in more detail below.

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.

At 31 December 2022, there was a reduction in management judgemental adjustments compared with 31 December 2021. Adjustments related to Covid-19 and for sector-specific risks were reduced as scenarios and modelled outcomes better reflected the key risks at 31 December 2022.

Methodology

Four global economic scenarios are 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 the group's top and emerging risks.

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 trends.

The consensus, 'Upside' scenario is constructed to be consistent with a 5% probability. The two Downside scenarios were given a combined probability weighting of 35%. The Central Scenario is assigned the remaining 60%. This weighting scheme is deemed appropriate for the unbiased estimation of ECL in most circumstances. However, management may 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.

Global economic growth is slowing and economic forecasts in the fourth quarter deteriorated in most markets. In North America and Europe, high inflation and rising interest rates have reduced real household incomes, dampening consumption and investment and lowering growth expectations. The effect of higher interest rate expectations and lower growth are evident in asset price expectations, with house price forecasts, in particular, significantly lower.

Economic forecasts are subject to a high degree of uncertainty. At the end of 2022, risks to the economic outlook included the persistence of inflation and the consequences that has for monetary policy. Rapid changes to public policy also increased forecast uncertainty. In Europe, risks relating to energy pricing and supply security remain significant. Geopolitical risks also remain significant and include prolonged and escalating Russia-Ukraine war, continued differences between the US and other countries with China over a range of economic and strategic issues and the evolution of UK's relationship with the EU.

The scenarios used to calculate ECL in the Annual Report and Accounts 2022 are described below.

The consensus Central scenario

HSBC UK's Central scenario reflects a low growth and higher inflation environment. The scenario features an initial period of below-trend GDP growth in most markets as inflation and tighter monetary policy causes a squeeze on business margins and households' real disposable income. Growth returns to its long term expected trend in later years as the BoE brings inflation back to target.

Our Central scenario assumes that inflation peaked at the end of 2022 but remains high through 2023 before moderating as energy prices and supply chain disruptions abate. The BoE is expected to keep interest rates elevated until inflation returns to target in 2024.

UK GDP is expected to decline by 0.8% in 2023 in the Central scenario and the average rate of UK GDP growth is 1.1% over the five-year forecast period.

The key features of our Central scenario are:

- Economic activity in UK continues to deteriorate.
- Unemployment rise moderately from historic lows as economic activity slows. Labour markets remain fairly tight across the UK.
- Inflation is expected to remain elevated across UK driven by energy and food prices. Inflation is subsequently expected to converge back towards the BoE's target over the next two years of the forecast.
- Policy interest rates will continue to rise in the near term but at a slower pace. Interest rates will stay elevated but start to ease as inflation returns to target.

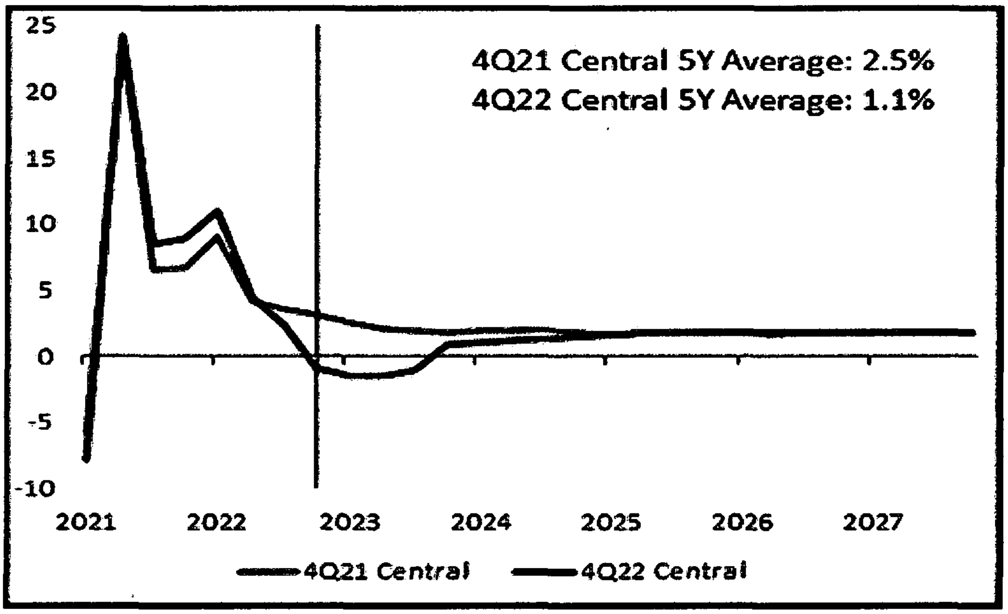
The Central scenario was first created with forecasts available in November, and reviewed continually until late December.

The following table describes key macroeconomic variables and the probability assigned in the consensus Central scenario applied at 31 December 2022 and 31 December 2021.

Central scenario	Average 2023 Q1-2027 Q4	Average 2022 Q1-2026 Q4
	UK%	UK%
GDP growth rate	1.1	2.5
Unemployment	4.3	4.3
Inflation rate	3.1	1.2
House price growth	0.4	3.5
Probability	60	60

The graph compares the respective Central scenario at year end 2021 with current economic expectations at the end of 2022.

GDP growth: Comparison of Central scenarios



The consensus Upside scenario

Compared with the consensus Central scenario, the consensus Upside scenario features stronger recovery in economic activity in the near term, before converging to long-run trend expectations. The scenario is consistent with a number of key upside risk themes. These include faster resolution of supply chain issues; a rapid and peaceful conclusion to the Russia-Ukraine war; and improved relations between the UK and the EU.

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Upside scenario.

Consensus Upside scenario best outcome	
	UK%
GDP growth rate	**4.4 (4Q24)**
Unemployment	**3.5 (4Q23)**
House price growth	**4.2 (1Q23)**
Inflation rate	**0.7 (1Q24)**
Probability	**5**

Note: Extreme point in the consensus Upside is 'best outcome' in the scenario, for example the highest GDP growth and the lowest unemployment rate, in first two years of the scenario. The date on which the extreme is reached is indicated in parenthesis. For inflation, lower inflation is interpreted as the 'best' outcome.

Downside scenarios

Downside scenarios explore the intensification and crystallisation of a number of key economic and financial risks. High inflation and the tighter monetary policy response have become key concerns for global growth. Supply chain disruptions intensify, exacerbated by an escalation in the spread of Covid-19, and rising geopolitical tensions drive inflation higher.

There also remains a risk that energy and food prices rise further due to the Russia-Ukraine war, putting further pressure on household budgets and firms' costs.

The possibility of inflation expectations becoming detached from BoE targets also remains a risk. A wage-price spiral triggered by higher inflation and pandemic-related labour supply shortages across could put sustained upward pressure on wages, aggravating cost pressures and the squeeze on household real incomes and corporate margins. In turn, it raises the risk of a more forceful policy response from the BoE, a steeper trajectory for interest rates and ultimately, deep economic recession.

The risks relating to Covid-19 remain are centred on the emergence of a new variant with greater vaccine resistance that necessitates the imposition of stringent public health policies.

The geopolitical environment also presents risks, including:

- a prolonged Russia-Ukraine war with escalation beyond Ukraine's borders;
- the deterioration of the trading relationship between the UK and the EU over the Northern Ireland Protocol; and
- continued differences between the US and other countries with China, which could affect sentiment and restrict global economic activity.

The consensus Downside scenario

In the consensus Downside scenario, economic activity is considerably weaker compared with the Central scenario. In this scenario, GDP growth weakens below the Central scenario, unemployment rates rise and asset prices fall. The scenario features a temporary supply side shock that keeps inflation higher than the baseline, before the effects of weaker demand begin to dominate, leading to a fall in commodity prices and to lower inflation.

The following table describes key macroeconomic variables and the probability assigned in the Consensus Downside scenario.

Consensus Downside scenario worst outcome	Worst outcome 2021-2025
	UK%
GDP growth rate	**(3.5) (3Q23)**
Unemployment	**5.8 (2Q24)**
House price growth	**(10.1) (2Q24)**
Inflation rate (min)	**(0.4) (4Q24)**
Inflation rate (max)	**10.8 (1Q23)**
Probability	**25**

Note: Extreme point in the consensus Downside is 'worst outcome' in the scenario, for example lowest GDP growth and the highest unemployment rate, in first two years of the scenario. The date on which the extreme is reached is indicated in parenthesis. Due to the nature of the shock to inflation in the downside scenarios, both the lowest and the highest points are shown in the table.

Downside 2 scenarios

The Downside 2 scenario features a deep global recession and reflects management's view of the tail of the economic distribution. It incorporates the crystallisation of a number of risks simultaneously, including further escalation of the Russia-Ukraine war, worsening of supply chain disruptions and the emergence of a vaccine-resistant Covid-19 variant that necessitates a stringent public health policy response.

This scenario features an initial supply-side shock that pushes up inflation and interest rates higher. This impulse is expected to prove short lived as a large downside demand shock causes commodity prices to correct sharply and global price inflation to fall as a severe and prolonged recession takes hold.

The table below describes key macro-economic variables and the probability in the Downside 2 scenario.

Downside 2 scenario worst outcome	UK%
GDP growth rate	**(6.9) (3Q23)**
Unemployment	**8.7 (2Q24)**
House price growth	**22.9 (2Q24)**
Inflation rate (min)	**(2.3) (2Q24)**
Inflation rate (max)	**13.5 (2Q23)**
Probability	**10**

Note: extreme point in Downside 2 is 'worst outcome' in the scenario, for example lowest GDP growth and the highest unemployment rate, in first two years of the scenario. The date on which the extreme is reached is indicated in parenthesis. Due to the nature of the shock to inflation in the downside scenarios, both the lowest and the highest points are shown in the table.

Scenario weighting

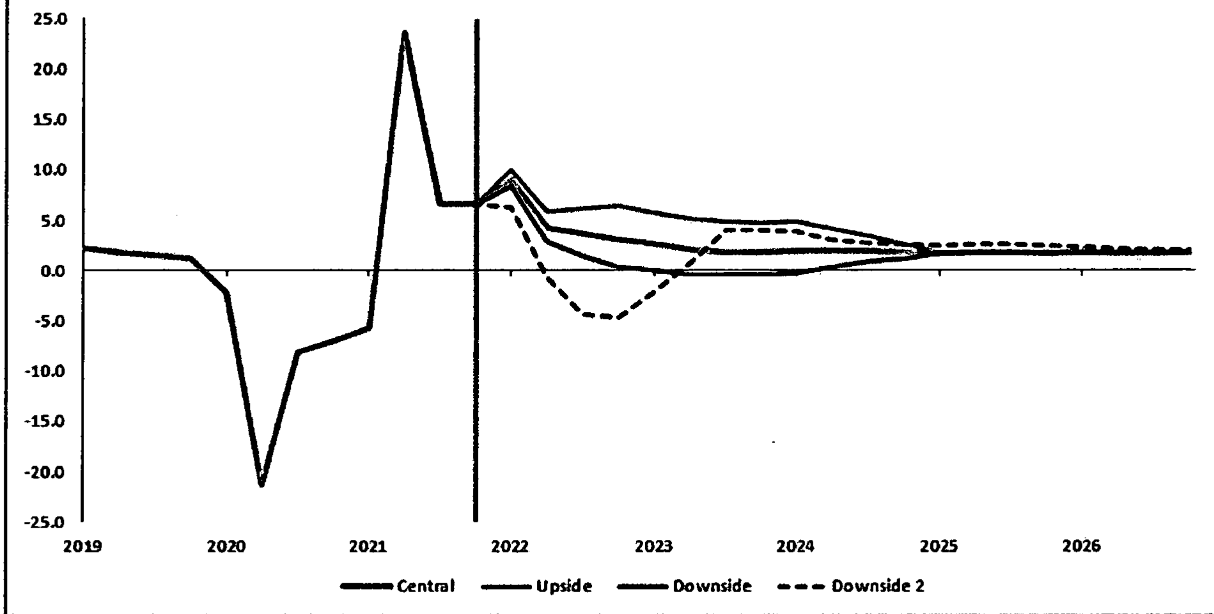
In reviewing the economic conjuncture, the level of uncertainty and risk, management has considered UK specific factors. This has led management to assign scenario probabilities that are tailored to its view of uncertainty.

Key consideration around uncertainty attached to the Central scenario projections focused on:

- the risks around gas supply security in Europe and subsequent impact on inflation and commodity prices and growth;
- further tightening of monetary policy and impact on borrowing costs in interest rate sensitive sectors, such as housing; and
- the ongoing risks to global supply chains.

In the UK, the surge in price inflation and a squeeze on household real incomes have led to strong monetary policy responses from the BoE. Higher interest rates have increased recession risks and the prospects for outright decline in house prices. The UK faces additional challenges from the rise in energy prices and accompanying deterioration in the terms of trade. For the UK, the consensus Upside and Central scenarios had a combined weighting of 65%.

Following graph show the historical and forecasted GDP growth rate for the various economic scenarios in UK.



Critical accounting estimates and judgements

The calculation of ECL under IFRS 9 involves significant judgements, assumptions and estimates. The level of estimation uncertainty and judgement has remained elevated since 31 December 2021, including judgements relating to:

- the selection and weighting of economic scenarios, given rapidly changing economic conditions and a wide distribution of economic forecasts. There is judgement in making assumptions about the effects of inflation and interest, global growth, supply chain disruption; and
- estimating the economic effects of those scenarios on ECL, particularly as the historical relationship between macroeconomic variables and defaults might not reflect the dynamics of current macroeconomic conditions.

How economic scenarios are reflected in the calculation of ECL

Models are used to reflect economic scenarios on ECL estimates. As described above, modelled assumptions and linkages based on historical information could not alone produce relevant information under the conditions experienced in 2022, and management judgemental adjustments were still required to support modelled outcomes.

HSBC Group have developed globally consistent methodologies for the application of forward economic guidance into the calculation of ECL for credit risk. These standard approaches are described below, followed by the management judgemental adjustments made, including those to reflect the circumstances experienced in 2022.

For our retail portfolios, 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 the 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.

This includes refining model inputs and outputs and using adjustments to ECL based on management judgement and higher-level quantitative analysis for impacts that are difficult to model.

The effect of management judgemental adjustments are considered for balances and ECL when determining whether or not a significant increase in credit risk has occurred and are attributed or allocated to a stage as appropriate. This is in accordance with the internal adjustments framework.

Management judgemental adjustments are reviewed under the governance process for IFRS 9 (as detailed in the section 'Credit risk management' on page 38. Review and challenge focuses on the rationale and quantum of the adjustments with a further review carried out by the second line of defence where significant. For some management judgemental adjustments, internal frameworks establish the conditions under which these adjustments should no longer be required and as such are considered as part of the governance process. This internal governance process allows management judgemental adjustments to be reviewed regularly and, where possible, to reduce the reliance on these through model recalibration or redevelopment, as appropriate.

The drivers of management judgemental adjustments continue to evolve with the economic environment, and as new risks emerge. Adjustments related to Covid-19 and for sector-specific risks were reduced as scenarios and modelled outcomes better reflected management expectations at 31 December 2022.

Management judgemental adjustments made in estimating the scenario-weighted reported ECL at 31 December 2022 are set out in the following table.

Management judgemental adjustments to ECL[1]	**Retail Total 2022**	Retail Total 2021
	£'000	£'000
Macroeconomic-related adjustments	**5**	3
Pandemic-related economic recovery adjustments	**–**	5
Other retail lending adjustments	**2**	10
Total	**8**	18

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

At 31 December 2022, management judgemental adjustments were an increase to ECL of £7.6m (31 December 2021 : £18m increase).

The decrease in adjustment impact relative to 31 December 2021 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 not fully reflected in the underlying data.

- Macroeconomic adjustments increased ECL by £2.2m during 2022 to £5.2m (31 December 2021: £3m). This adjustment relates to inflation and interest rates where results in affordability risks were not fully captured by the modelled output.
- Pandemic-related economic recovery adjustments of £5m at 31 December 2021 to adjust for the effects of the volatile pace of recovery from the Covid-19 pandemic have been discontinued, given the key economic variables driving ECL models have now stabilised after the rapid improvements during the emergence from the pandemic.
- An adjustment of £2.4m was recognised at 31 December 2022 to reflect the impact of updating ECL to align to December 31st balances (modelled ECL has historically been booked using a one month lag). The impact of updating quarter end balance was larger than in prior quarters, due to the increases in Credit Card delinquency through December. The increase in delinquency is likely to have been driven by a seasonal spike in delinquency together with the impact of postal delays (impacting customer statements and cheques) during December. Other retail lending adjustments of £10m at 31 December 2021 to address areas such as model recalibration and redevelopment, customer relief and data limitations, including a high risk sector adjustment have been discontinued.

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.

For retail credit risk exposures, the sensitivity analysis includes ECL for loans and advances to customers related to defaulted obligors. This is because the retail ECL for secured mortgage portfolios including loans in all stages is sensitive to macroeconomic variables.

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 also 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]	**2022**	2021
	UK	UK
	£m	£m
ECL coverage of loans and advances to customers at 31 December 2022		
Reported ECL	**131**	102
Consensus Scenarios		
Central scenario	**119**	82
Upside scenario	**99**	68
Downside scenario	**132**	106
Downside 2 scenario	**207**	246

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

Credit cards and other unsecured lending are sensitive to economic forecasts, which have deteriorated in 2022.

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 and financial guarantees. If movements were calculated on a year-to-date basis they would only reflect the opening and closing position of the financial instrument.

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 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 probability of default ('PD') movements of the financial instruments transferring stage. This is captured, along with other credit quality movements in the 'changes in risk parameters – credit quality' line item.

Changes in 'New financial assets originated or purchased', 'Assets derecognised (including final repayments)' and 'Changes to risk parameters – further lending/repayment' represent the impact from volume movements within the group'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	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
At 1 Jan 2022	**14,391,709**	**(19,018)**	**332,318**	**(59,464)**	**98,716**	**(23,276)**	**14,822,743**	**(101,758)**
Transfer of financial instruments								
- transfers from stage 1 to stage 2	**(3,220)**	**53**	**3,220**	**(53)**	**–**	**–**	**–**	**–**
- transfers from stage 2 to stage 1	**1,316**	**(137)**	**(1,316)**	**137**	**–**	**–**	**–**	**–**
- transfers to stage 3	**–**	**–**	**(69)**	**24**	**69**	**(24)**	**–**	**–**
- transfers from stage 3	**119**	**(10)**	**71**	**(15)**	**(190)**	**25**	**–**	**–**
Net remeasurement of ECL arising from transfer of stage	**–**	**78**	**–**	**(124)**	**–**	**–**	**–**	**(46)**
New financial assets originated or purchased	**54,636**	**(524)**	**–**	**–**	**–**	**–**	**54,636**	**(524)**
Changes to risk parameters- further lending/repayments	**19,103**	**942**	**594,800**	**(1,624)**	**70,656**	**3,701**	**684,559**	**3,019**
Changes to risk parameters (credit quality)	**–**	**(4,361)**	**–**	**(56,814)**	**–**	**(50,620)**	**–**	**(111,795)**
Asset derecognised (including final repayments)	**(489,508)**	**9,429**	**(92,295)**	**20,330**	**(16,209)**	**930**	**(598,012)**	**30,689**
Assets written off	**–**	**–**	**–**	**–**	**(49,236)**	**49,236**	**(49,236)**	**49,236**
At 31 Dec 2022	**13,974,155**	**(13,548)**	**836,729**	**(97,603)**	**103,806**	**(20,028)**	**14,914,690**	**(131,179)**
ECL release/(charge) for the period		**5,563**	**–**	**(38,232)**	**–**	**(45,988)**		**(78,657)**
Recoveries		**–**		**–**		**17,362**		**17,362**
Total change in ECL for the period		**5,563**		**(38,232)**		**(28,626)**		**(61,295)**

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)
Net new and 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)
Change in model used for ECL calculation	–	–	–	–	–	–	–	–
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

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 2022, these amounted to £0.9bn (2021: £0.9bn) and were classified as stage 1 with no ECL. The reconciliation excludes other financial assets measured at amortised cost. As at 31 December 2022, these amounted to £111m (2021: £49m) 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 probability of default ('PD'), whereas stages 1 and 2 are determined based on relative deterioration of credit quality since initial recognition. Accordingly, for non-credit-impaired financial instruments, there is no direct relationship between the credit quality assessment and stages 1 and 2, although typically the lower credit quality bands exhibit a higher proportion in stage 2.

The five credit quality classifications defined below each encompass a range of more granular, internal credit rating grades, as well as external rating:

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 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	**869,089**	**–**	**–**	**–**	**–**	**869,089**	**–**	**869,089**
- stage 1	**869,089**	**–**	**–**	**–**	**–**	**869,089**	**–**	**869,089**
Loans and advances to customers at amortised cost	**1,446,422**	**749,855**	**1,173,700**	**82,604**	**60,941**	**3,513,522**	**(129,787)**	**3,383,735**
- stage 1	**1,446,422**	**749,855**	**460,551**	**–**	**–**	**2,656,828**	**(12,378)**	**2,644,450**
- stage 2	**–**	**–**	**713,149**	**82,604**	**–**	**795,753**	**(97,381)**	**698,372**
- stage 3	**–**	**–**	**–**	**–**	**60,941**	**60,941**	**(20,028)**	**40,913**
Other financial assets measured at amortised cost[1]	**110,690**	**–**	**–**	**–**	**–**	**110,690**	**–**	**110,690**
- stage 1	**110,690**	**–**	**–**	**–**	**–**	**110,690**	**–**	**110,690**
Loans and other credit related commitments	**9,577,094**	**710,786**	**197,040**	**4,294**	**42,865**	**10,532,079**	**(1,392)**	**10,530,687**
- stage 1	**9,577,094**	**710,786**	**160,358**	**–**	**–**	**10,448,238**	**(1,170)**	**10,447,068**
- stage 2	**–**	**–**	**36,682**	**4,294**	**–**	**40,976**	**(222)**	**40,754**
- stage 3	**–**	**–**	**–**	**–**	**42,865**	**42,865**	**–**	**42,865**
At 31 Dec 2022	**12,003,295**	**1,460,641**	**1,370,740**	**86,898**	**103,806**	**15,025,380**	**(131,179)**	**14,894,201**
Loans and advances to banks at amortised cost	908,547	–	–	–	–	908,547	–	908,546
- stage 1	908,547	–	–	–	–	908,547	–	908,546
Loans and advances to customers at amortised cost	1,738,761	688,711	722,671	33,456	64,649	3,248,249	(100,256)	3,147,993
- stage 1	1,738,761	688,711	463,475	–	–	2,890,948	(17,710)	2,873,238
- stage 2	–	–	259,196	33,456	–	292,653	(59,270)	233,382
- stage 3	–	–	–	–	64,649	64,649	(23,276)	41,373
Other financial assets measured at amortised cost[1]	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	93,824	4	–	10,592,215	(1,307)	10,590,908
- stage 2	–	–	35,260	4,405	–	39,666	(194)	39,472
- stage 3	–	–	–	–	34,067	34,067	–	34,067
At 31 Dec 2021	12,866,955	1,016,518	851,756	37,866	98,716	14,871,810	(101,758)	14,770,053

[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 that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition, or
- 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.

Forborne loans and advances

Forbearance measures consist of concessions towards an obligor that is experiencing or about to experience difficulties in meeting its financial commitments ('financial difficulties').

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.

Up until the end of 2021 we classed loans as forborne when we modified the contractual payment terms where we had significant concerns about the borrowers' ability to meet contractual payments when due.

Retail portfolio non-payment related concession have been identified from 2022 when our internal policies where changed.

The comparative disclosures have been presented under the prior definition of forborne for the portfolios.

Credit quality of forborne loans

Where a material concession has been granted, the loan will be classified as credit impaired if it is not already so classified. In isolation, non-payment forbearance measures may not result in the loan being classified as credit impaired unless combined with other indicators of credit impairment. These are classed as performing forborne loans.

Forborne loans are classified as credit impaired 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. Any forborne loans not considered credit impaired will remain forborne for a minimum of two years from the date that credit impairment no longer applies.

Forborne loans and recognition of expected credit losses

Forborne loans expected credit loss assessments reflect the higher rates of losses typically experienced with these types of loans such that they are in stage 2 and stage 3.

The following table shows the gross carrying amounts of the Entity's holdings of forborne loans and advances to customers by stage. Forborne 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 forborne loans.

	2022			
	Performing - Forborne		Non-Performing - Forborne	Total Forborne
	Stage 1	Stage 2	Stage 3	Total
	£'000	£'000	£'000	£'000
Gross carrying amount				
Personal	–	15,729	19,613	35,342
- credit cards	–	7,743	12,961	20,704
- other personal lending which is unsecured	–	7,986	6,653	14,638
At 31 Dec 2022	–	15,729	19,613	35,342
Allowance for ECL	–	–	–	–
Personal	–	(2,730)	(10,040)	(12,770)
- credit cards	–	(816)	(6,257)	(7,073)
- other personal lending which is unsecured	–	(1,914)	(3,784)	(5,698)
At 31 Dec 2022	–	(2,730)	(10,040)	(12,770)

	2021			
	Performing - Forborne		Non-Performing - Forborne	Total Forborne
	Stage 1	Stage 2	Stage 3	Total
	£'000	£'000	£'000	£'000
Gross carrying amount				
Personal	–	–	19,513	19,513
- credit cards	–	–	13,719	13,719
- other personal lending which is unsecured	–	–	5,794	5,794
At 31 Dec 2021[1]	–	–	19,513	19,513
Allowance for ECL	–	–	–	–
Personal	–	–	(7,390)	(7,390)
- credit cards	–	–	(4,959)	(4,959)
- other personal lending which is unsecured			(2,432)	(2,432)
At 31 Dec 20211	–	–	(7,390)	(7,390)

[1] *Forborne exposures and allowances for ECL at 31 December 2021 have not been restated and agree with the policies and disclosures presented in the Annual Report and Accounts 2021.*

Market risk management

Market risk is the risk of adverse financial impact on trading activities arising from changes in market parameters such as interest rates.

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 remains within approved limits.

At 31 Dec 2022	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	**510,089**	**65,000**	**100,000**	**194,000**	**–**	**–**	**869,089**
Loans and advances to customers	**548,627**	**541,736**	**306,893**	**1,319,181**	**18,888**	**648,410**	**3,383,735**
Other assets	**99,304**	**352**	**624**	**2,158**	**103**	**113,721**	**216,262**
Total assets	**1,158,020**	**607,088**	**407,517**	**1,515,339**	**18,991**	**762,131**	**4,469,086**
Liabilities							
Deposits by banks	**763,147**	**520,000**	**290,000**	**1,285,000**	**–**	**–**	**2,858,147**
Customer accounts	**528,883**	**69,007**	**118,972**	**171,109**	**–**	**–**	**887,971**
Other liabilities	**111,722**	**–**	**–**	**–**	**–**	**44,261**	**155,983**
Subordinated liabilities	**17,380**	**–**	**–**	**79,000**	**–**	**–**	**96,380**
Shareholders' equity	**–**	**–**	**–**	**–**	**–**	**470,605**	**470,605**
Total equity and liabilities	**1,421,132**	**589,007**	**408,972**	**1,535,109**	**–**	**514,866**	**4,469,086**
Interest rate sensitivity gap	**(263,112)**	**18,081**	**(1,455)**	**(19,770)**	**18,991**	**247,265**	**–**
Cumulative interest rate sensitivity gap	**(263,112)**	**(245,031)**	**(246,486)**	**(266,256)**	**(247,265)**	**–**	**–**

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
Financial investments	–	–	–	–	–		–
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
Notional value:							
Interest rate swaps	–	–	–	–	–	–	–
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)	–	–

Liquidity risk management

The Entity is part of the Domestic Liquidity Sub-group ("Liquidity Group") of HSBC UK and therefore part of the internal liquidity control and management structure of HSBC UK. The Entity's liquidity position is managed as part of the HSBC UK Liquidity Group, under which members agree to provide liquidity support when necessary.

The Entity has an agreed funding limit with HSBC UK, and borrowing levels against this are monitored on a monthly basis by the Entity's Asset and Liability Committee ('ALCO').

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. 2022 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

	2022 £'000	2021 £'000
Short-term employee benefits	**659**	576
Post-employment benefits	**26**	25

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.

	2022		2021	
	Highest balance during the year	**Balance at 31 December**	Highest balance during the year	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Cards	**26**	**13**	30	5
Other[1]	**26**	**9**	130	102

[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

	2022		2021	
	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	**4,176**	**3,381**	4,093	3,362

[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.*

	2022 £'000	2021 £'000
Income statement		
Interest expense	—	510
Fee income	—	11
Other operating income	—	(458)
General and administrative expenses	**34,079**	37,987

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

	2022		2021	
	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	**23**	**23**	–	–
Additional tier 1 equity	**60,000**	**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.*

	2022	2021
	£'000	£'000
Income statement		
Dividend expense	**4,575**	1,150

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

	2022		2021	
	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	**744**	**117**	201	102
Liabilities				
Other liabilities	**8,022**	**4,890**	9,619	5,197

[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.*

	2022	2021
	£'000	£'000
Income statement		
Interest expense	**100**	4
General and administrative expenses	**2,619**	2,168

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

	2022		2021	
	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	**964,000**	**869,000**	1,931,543	908,547
Other assets	**55,087**	**34,665**	36,495	19,369
Liabilities				
Deposits by banks	**2,695,000**	**2,635,000**	2,590,000	2,400,000
Subordinated amounts due	**96,699**	**96,380**	96,367	96,367
Additional tier 1 equity	**9,000**	**9,000**	9,000	9,000
Other liabilities	**247,563**	**240,869**	17,092	7,334

[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.*

	2022	2021
	£'000	£'000
Income statement		
Interest income	**10,488**	1,596
Interest expense	**36,950**	13,444
Fee income	**–**	(18)
Fee expense	**–**	1,291
General and administrative expenses	**7,943**	3,351
Dividend expense	**27,428**	–

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

	2022		2021	
	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	–
Additional tier 1 equity	–	–	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.*

	2022	2021
	£'000	£'000
Income statement		
Interest expense	–	510
Other operating income	–	458
Dividend expense	–	3,425

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 2022 of £11m (£0.04p per share) is recommended by the Directors.