

**Sainsbury's Bank plc**

**Annual Report and Financial Statements  
for the year ended 28 February 2021**

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## Financial headlines

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# £(162)m

Statutory (loss)/profit before tax  
(2020: profit £5m)

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# £(36)m

Underlying (loss)/profit before tax  
(2020: profit £33m)

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# 2.4%

Net interest margin (underlying)  
(2020: 2.5%)

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# 1.1%

Bad debt asset ratio  
(2020: 0.7%)

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# 90%

Cost : income ratio (underlying)  
(2020: 75%)

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# 17.6%

CET1 Capital Ratio (transitional)  
(2020: 14.1%)

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# 125%

Net Stable Funding Ratio  
(2020: 110%)

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**i** Performance, including reference to the above headlines, is explained in the Business review and Financial review sections on pages 3 and 18.

The Alternative Performance Measures have been defined and reconciled to the statutory disclosures on page 86.

# Strategic Report






The Directors present their strategic report of Sainsbury's Bank plc ('the Bank') for the year ended 28 February 2021.

The Bank is a public company limited by shares, registered in England and domiciled in the United Kingdom. Its registered office is 33 Holborn, London, EC1N 2HT. Our principal place of business is 3 Lochside Avenue, Edinburgh, EH12 9DJ.

## Business model

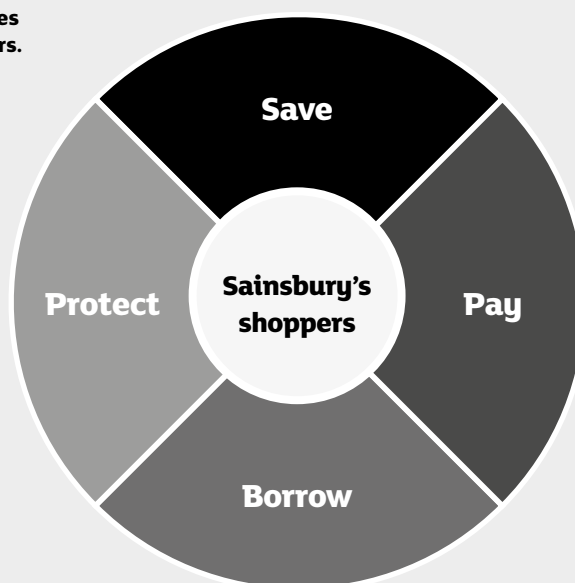
**We provide a range of retail banking services and related financial services wholly within the UK. We provide simple, mobile led financial services for Sainsbury's and Argos customers.**

### Saving & lending




-  Savings
-  Loans
-  Credit cards
-  Argos storecards<sup>1</sup>
-  Mortgages<sup>2</sup>

- Funds are raised through savings deposits and wholesale sources. We lend these to customers or hold them as liquid assets.
- Our net interest income is the difference between the interest we earn on lending and the interest we pay on funds raised.
- Our saving and lending products are sold and serviced online or by telephone and, in the case of Storecards, in an Argos store.

<sup>1</sup> Argos Storecards are funded by Sainsbury's Bank and are operated by our subsidiary, Home Retail Group Card Services Limited.  
<sup>2</sup> We no longer accept new mortgage business.



### Commission-based

- Insurance 
- ATMs 
- Travel money 

- Insurance products are offered via introducer contracts with third-party insurance partners and income is received through commission arrangements or through a panel model for Car and Home where we act as a broker to a number of underwriters. All products are available online or via telephone.
- Foreign currency is acquired wholesale and sold to customers at a retail rate with resulting margin. We earn fees on prepaid cards and money transfer services. We have Travel Money Bureaux in Sainsbury's supermarkets and have an online presence.
- Our ATMs have a physical presence in Sainsbury's and Argos stores.

As a bank authorised by the Prudential Regulation Authority (PRA), together with the Financial Conduct Authority (FCA), we are required to raise and hold specified minimum levels of capital (see note 36), and hold specified levels of liquid assets in order to meet our financial commitments as they are expected to fall due (see liquidity risk disclosures at note 35).

Our underlying profitability reflects the difference between income generated from our products compared to costs arising from marketing and operating those products, supplier and head office related costs, charges arising from impairment of customer balances and other realised gains and losses – these items are explained in the Financial review on page 18.

We are a wholly owned subsidiary of J Sainsbury plc, governed by our own Board and Executive Committee, independent from J Sainsbury plc (see Risk overview and Governance sections on pages 5 and 14).

The current financial statements continue to report the performance and position of the Bank as a standalone entity. Further disclosure on the combined Financial Services segment of the Sainsbury's Group ('the Group') is provided in the J Sainsbury plc Group financial statements and more information on transactions with Group companies is provided at note 40.

## Market context

### Loans

The market for unsecured personal lending was challenging for Loans as COVID-19 had a significant impact on customers' borrowing appetite and ability to pay, in an uncertain economic environment.

To support customers, we designed, tested and implemented our Emergency Payment Freeze strategy to assist customers impacted financially by COVID-19.

We took several actions to mitigate the risk exposure of the Bank, including tightening credit criteria, reducing our marketing presence, scaling back our market competitiveness and restricting maximum lending to £15k. From these safeguards and lower macroeconomic demand, new business lending significantly reduced. However, in the second half we began reversing these actions and have seen a corresponding uplift in momentum.

Market leading pricing was reintroduced at the end of 2020, giving our customers excellent value and driving good quality new business.

### Credit Cards



Similar to loans and the broader financial services market, the 20/21 financial year has been challenging for Credit Cards due to the impacts of COVID-19. As the situation regarding the pandemic evolved, the Bank moved quickly to support existing customers in terms of Emergency Payment Freeze capability and took necessary steps to ensure credit risk policy was adopted to mitigate potential impacts linked to the market stress.

In the second half we saw a gradual but strong recovery, in terms of acquisition and existing customer performance.

### Mortgages

In September 2019, we announced that we had ceased new mortgage sales in line with our objective to reshape the balance sheet and focus on capital efficient products with the most connectivity to Sainsbury's shoppers. Sainsbury's Bank continues to offer retention products as existing customers' fixed rate deals end.

As for other lending products, we have introduced Emergency Payment Freezes to support customers impacted by COVID-19; this support has been extended to July 21.

### Savings

Due to COVID-19 restrictions and the market-wide observed consumer spending behaviour changes, the savings market grew by 6% between January and November to £1.3tn. Following our exit from the mortgage market and Base Rate reductions, we have re-priced our existing variable rate customers to manage the overall book size to optimise liquidity. Balances have reduced from £6.3 billion in February 2020 to £5.1 billion in February 2021, resulting in our market share reducing from 0.5% to 0.4%, which played a key role in stabilising our balance sheet.

Changes to Base Rate, combined with changes to consumer behaviour as a result of lockdown restrictions, have meant that the key competitor best buy rates have dropped from 1.31% to 0.50% and rates are expected to fall further as current market conditions continue. In line with the market, our rates have decreased through carefully managed re-pricing which has reduced the interest payable whilst meeting the requirements of the wider business.



### ATMs

ATM transactions have fallen 42% across the industry in 20/21 due to the impact of COVID-19 and lockdown restrictions. Our fall in transactions at 47% is greater than the reduction in the market and reflects the reduction in the number of ATMs as well as the reduced usage. Our average cash withdrawal has increased by 23% to over £100 reflecting customers visiting supermarkets less frequently. We have made significant cost savings through the year by right sizing our ATM estate to reflect the new lower levels of demand for cash.

### Insurances



The market has been significantly impacted by COVID-19.

The Car Insurance market has seen new car sales reduce as dealers have been closed and consumers are working from home. This has resulted in an increase in discounting through aggregator channels across the market, with some brokers reducing their margins significantly to maintain volume targets. Direct insurers have also seen a significant reduction in claims as the population stopped travelling, assisting some in funding lower premiums. This made it a very competitive trading environment for the Bank. Overall policies written fell 7% in the year.

The Home insurance market was adversely impacted during the first lockdown but recovered in the second half of the financial year as the stamp duty holiday helped house sales to recover. Despite the challenging environment total policies written in the year increased 3%.

The Pet Insurance market has been positively impacted by COVID-19 as the increase in the population working from home has resulted in a significant increase in demand for puppies and kittens.

Travel Insurance has been impacted most significantly by the various travel restrictions throughout the year. Our performance has been broadly in line with the market.

### Travel Money

The entire travel market has been hugely impacted by the travel bans imposed due to COVID-19. We were able to move over 1,000 colleagues to support in Sainsbury's supermarkets from March 2020, which both supported colleagues and reduced the impact on our P&L. We brought a small number of colleagues back from July to September when we opened our busiest 34 bureaux as the travel ban was temporarily lifted. We closed them again in September and since then they have remained closed.



## Strategy

The Bank is aligned to the Sainsbury's Group strategic priority to focus on brands that deliver with a customer and profit focus whilst supporting the core food business. We aim to drive value for the Sainsbury's Group by being an agile, capital and cost-efficient provider of simple, mobile led financial services for Sainsbury's and Argos customers. We know that when customers take out a Bank product, they become more loyal and go on to spend more in Sainsbury's and Argos stores.

We aim to use the power of Nectar to win customers and grow more valuable market share.



**Brands that Deliver**

- Customer and profit focus
- Supporting the core food business



**Connected to Customers**

Know and serve our customers better, use the power of Nectar

In September 2019, the Bank announced its five-year strategy, outlining its key objectives and how the strategy will be delivered. Since the announcement, the market has changed considerably due to the impacts of COVID-19 altering the pathway of achieving our strategic goals. Our balance sheet position has reduced to mitigate against the risks from poorer economic conditions. However, our focus continues to be to rebuild and reshape our balance sheet in a safe and effective manner while simplifying and strengthening the organisation.

VISION	To be the provider of financial services for loyal Sainsbury's Group customers			
OBJECTIVE	An agile, capital and cost-efficient provider of simple, mobile led financial services			
PRIORITIES	Reshape the balance sheet	Strengthen the business		Simplify the organisation
	<ul style="list-style-type: none"> <li>— Improve margins</li> <li>— Develop AFS proposition</li> <li>— Improve card and insurance momentum</li> <li>— New FS model with Nectar at the core</li> <li>— Run off mortgage book safely</li> </ul>	<b>Focus on:</b> <ul style="list-style-type: none"> <li>— Operational resilience</li> <li>— Conduct</li> <li>— Capital efficiency</li> </ul>	<b>Build core competency in:</b> <ul style="list-style-type: none"> <li>— Customer experience</li> <li>— Digital</li> <li>— Data and analytics</li> <li>— Credit/Operational risk</li> <li>— Partnerships</li> </ul>	<ul style="list-style-type: none"> <li>— Right size the cost base</li> <li>— Rationalise product offering</li> <li>— Review vendor/supplier arrangements</li> <li>— Optimise cross-Group synergies</li> </ul>
	Whilst operating within Risk Appetite			
	'Best-in-class' execution delivered by an outstanding and engaged team			
FINANCIAL SERVICES METRICS	Customer	Colleague	Financial	Safe and Sound

Our performance in the year is covered in the Business review below and the Financial review on page 18.

## Business review

Reflecting the changing economic environment driven by COVID-19, the Bank has made an underlying loss in the year. We have seen significantly reduced demand across consumer credit, and less activity in our fee-based products, particularly Travel Money and ATMs. We have also made a significant provision in anticipation of future credit losses, largely reflective of predictions for unemployment, partially offset by management actions on funding and costs. In line with guidance at half year, the Bank returned to profit in the second half to deliver underlying operating loss of £36 million for the financial year.

Despite challenges from the pandemic, we have delivered great value financial solutions and support for the Sainsbury's customer whilst improving our digital and operational services. We have maintained a strong Net Promoter Score (NPS) performance for our products and remain in the top quartile for banks. We have accelerated our digitisation journey with 70% of customers receiving paperless statements and over two thirds of our customer base now registered for online banking, with credit cards now over 80%.

Following lower consumer demand and a tightening of credit appetite, our customer numbers have decreased 14%, with the largest reduction seen in Travel Insurance, down 64% year-on-year. Nectar continues to be integral to our strategy and a key differentiator for Sainsbury's Bank with over 77% of our customers holding a Nectar card and benefiting from Nectar points and rewards across a range of products. We successfully introduced a new Nectar Credit Card offering up to 10,000 Nectar points for customers seeking rewards on spending with our Nectar partners. Nectar related applications are up 318% in the last quarter of FY20/21 compared to the same quarter last year. We have expanded our marketing channels and are driving more direct acquisition (as opposed to via price comparison sites) with total direct sales increasing by 6% and direct digital sales increasing by 72%.

Underlying income is 32% lower, driven by a decline in market demand for borrowing products, the closure of our Travel Money business amidst lockdown restrictions across the United Kingdom and changes in consumer spending behaviour whilst in lockdown. This was partly offset by a significant reduction in savings rates following the reduction in the Bank of England Base Rate and lower customer deposits.

Despite a challenging market for Insurance, with the pandemic driving very competitive market pricing, we have remained resilient with Insurance income in line with the prior year. In Car and Home, new business demand was down led by new car registrations and home sales, but this was offset by strong retention growth year on year. In line with our strategic priority to improve Insurance momentum, we have invested this year in our acquisition and servicing platforms which offers improved payment functionality, live chat for new customers and has integrated Nectar into the customer journey. As a result, our Insurance book now holds over a quarter of a million policies. We also launched new Pet Insurance cover and introduced multifactor authentication on our online web portal, minimising information security risks, to provide additional protection for our customers and their pets. In conjunction with buoyant demand as lockdown saw increased numbers of new pet owners, this drove a 96% increase in Pet Insurance new business volumes.

The cost agenda continues to be a key priority for the business where we aim to deliver sustainable cost savings as we adapt to changes in the market. Successful cost initiatives delivered in the year include resizing our ATM estate and improving the terms of some of our key supplier contracts. A large component of our costs are colleague costs, around 29%, which have reduced 21%, partly in relation to lower Travel Money colleague costs as staff were redeployed into the stores after Bureaux were closed from April. Colleague costs excluding Travel Money reduced by 10% supported by management action to reduce our colleague headcount as part of our Target Operating Model review.

Through action taken to protect the Bank against the economic uncertainty, by tightening credit criteria for new business early in the initial lockdown, and as a result of lower consumer finance demand, our Loans and Credit Card lending balances have reduced 28% and 27% respectively. Our Mortgage retention was lower than market as we diverted investment toward COVID-19 requirements to sustain other segments of the business. Whilst COVID-19 has impacted our strategic aim of reshaping the balance sheet, we are now able to regrow and shape our customer portfolio in the coming years to focus on capital efficient, Nectar-led products with the most connectivity to Sainsbury's shoppers.

Our approach to balance sheet management has promoted a strong capital position to absorb the losses of the pandemic and manage liquidity. The CET1 ratio has increased 3.5% to 17.6%, with the capital released as a result of the contraction in balances more than offsetting the loss made in the year. The LCR has increased 186% to 306% driven by a change in customer behaviour requiring less business outflows and management action to improve the Bank's funding capacity.

### Supporting our customers

We continued to serve our 1.8 million customers throughout the pandemic through our digital channels and contact centres. Supporting our customers as their needs change has never been more critical.

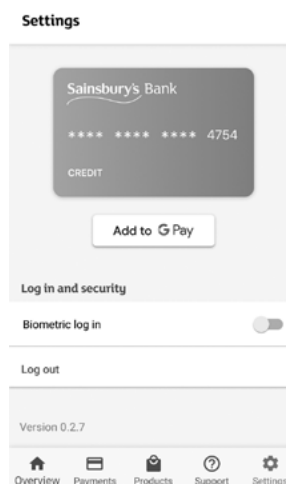
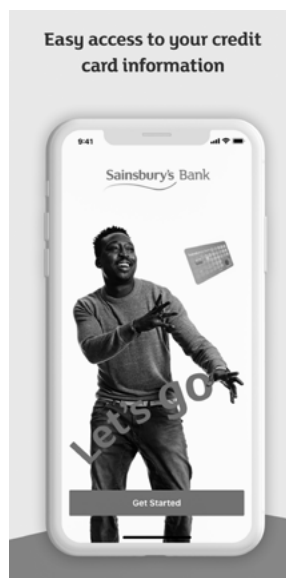
The Bank offered payment holidays across all of its lending products to support customers who were impacted by COVID-19. Over 40,000 payment holidays were granted at a value of £429 million, 93% have returned to normal payment schedules or fully repaid the loan after the expiry of their EPF to date. Our contact centre staff played a critical role in managing the customer experience to ensure each case was treated on an individual basis to ensure the right outcome was achieved.

### Supporting our colleagues

Lockdown began at the beginning of the financial year requiring quick and effective action to maintain operations and to ensure our colleagues are protected during this unprecedented time. We invested in our colleagues by covering expenses for home office set up and made our offices COVID-19 safe with social distancing measures. Travel Money colleagues from closed Bureaux were redeployed into Sainsbury's supermarkets to support our Sainsbury's store colleagues when it was needed most.

### Our digital strategy in action

The Bank has continued to invest in digital tools as well as continuing to build on our data and analytics capability. We are making good progress with our objective of being an agile, capital and cost-efficient provider of simple, mobile led financial services and we have seen an increase in the number of customers using our apps to manage their finances.



**Our Credit Card app** launched in early 2019 and now has 375,000 registered users, with just under half of our active customer base now registered. The app offers a simple and fast way to access account information and view transactions while on the go. Customers have been using it to check their Credit Card balance, credit limit, available spend, and transactions. The latest version of the app went live in early 2021 providing customers with a pending transactions feature, a monthly summary of transactions, the ability to manage direct debits and additional security designed to protect online customers against fraud.

In addition, further functionality was added including a credit limit indicator to allow customers to see at a glance if they are close to their limit and Google Pay digital wallet capability for customers wanting to use their handheld device for purchases. These improvements have contributed to fantastic customer feedback and have driven up our ratings on the Apple App Store from 3.6 to 4.8 out of 5. These changes pave the way for exciting future developments to drive more customers onto the app.

We have been investing in our **Loans and Savings** application journey, to speed up and streamline the process for customers. For many customers this will mean no more cumbersome paper trails as they can use their mobile phones to complete our required checks. And they'll get their accounts set up quicker, and loan funds sooner due to new pre-approval checks.

Our **Car & Home Insurance** digital evolution across acquisition and servicing platforms is well underway. Customers can now pay online, see Nectar offers as part of the sales journey and they can 'Live Chat'. Our customers are now self-serving more than ever before, with over 60% of Car & Home Insurance customers now requesting service changes online rather than over the phone, an increase of 103% since 2019.

In addition, our **Insurance app**, which launched in January 2019 for Car & Home, was amongst the first of its kind to allow policyholders to manage their Insurance via their smart device. Essentially, it allows customers to make changes to their policy and to see all the information they need in one place, giving them quick and easy access to their policies wherever and whenever they need it, and information about what to do in the event of a claim.



Carry your car & home policies with you.

### Delivering value for our shareholders

In order to maximise the shareholder value we made six commitments at our Capital Markets day in September 2019 and have summarised the progress to date against each of them below.

- 1. Stop putting cash into financial services.** The Bank has received no capital from the parent this year, and our capital ratios have grown. We have a significant capital surplus and strong liquidity and we remain confident that Financial Services will not require capital injections from the Group.
- 2. Improve returns.** We committed to double underlying profits and reach double digit ROCE within five years. We are still on track to double profit and returns in our Financial Services business within five years, despite the challenges of the current environment.  
*Note this commitment is based on consolidated financial services (including Argos Financial Services) which has a ROCE of (1.4)% (FY20: 6.3%) compared to the Bank stand-alone ROCE (3.9)% (FY20: 2.7%).*
- 3. Financial services to become cash generative.** We remain committed to paying dividends to our parent within five years and are taking action against our priorities to enable future cash distributions to the Group.

- 4. Transform the cost base.** We committed to reducing the cost to income ratio to c50% within five years. We continue to take action to implement initiatives to drive income growth and reduce costs, including a reduction in colleague headcount of 11% year on year (spot full time equivalent, 9% including contractors).

*Note this commitment is based on consolidated financial services (including Argos Financial Services) which has a cost to income of 72% (FY20:66%) compared to the Bank stand-alone ratio of 90% (FY20: 75%).*

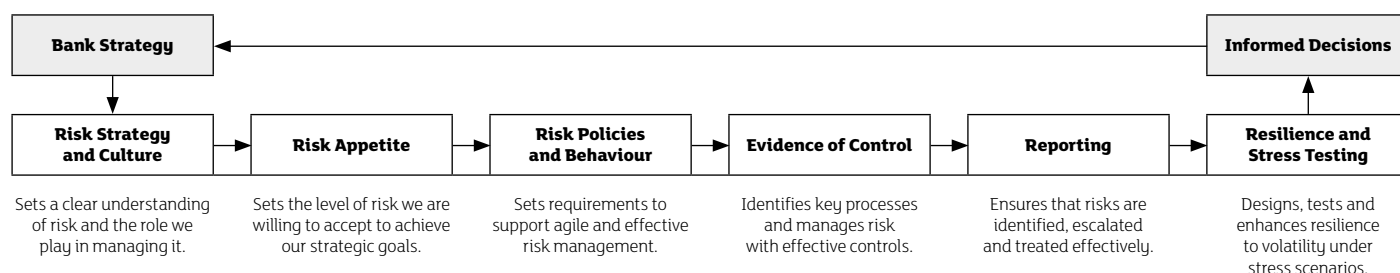
- 5. Reduce risk profile to the Group.** Whilst COVID-19 has delayed our strategic aim of reshaping the balance sheet, we are now able to regrow and shape our customer portfolio in the coming years to focus on capital efficient, Nectar-led products with the most connectivity to Sainsbury's shoppers. We continue to operate with sufficient capital and liquidity buffers to weather potential significant stress scenarios in the future.
- 6. Focus on Sainsbury's customer base.** We are working to increase connectivity and value for the Group and continue to work in enhanced cross group workstreams to ensure delivery of this key priority. Our focus is to enhance our digital connectivity with the Group and to provide customers convenient and simple access to financial services as part of their shopping experience.

## Risk overview

### Introduction

Effective enterprise-wide risk management is a core component of our strategy and operations. We adopt a holistic, end-to-end view of risk, ensuring that the key risks arising from our activities are effectively identified, assessed and controlled. Our objective is to support the strategy of the Bank by thinking broadly about risks and managing them in an appropriate manner relative to the size and complexity of our business.

Our approach to enterprise-wide risk management includes the following key steps:



### Risk strategy and culture

Our risk strategy and culture supports our business strategy and ensures it is delivered in a responsible and sustainable manner. This sets a clear, shared understanding of the risks we face and the role each of us plays in managing it. The following key aims and principles underpin our risk strategy and culture:

<b>Aims (what)</b>	<b>Insightful</b>	<b>Customer-Focused</b>	<b>Alert</b>	<b>Resilient</b>	<b>Engaged</b>
<b>Principles (how)</b>	We identify and manage risk concentrations	Good customer outcomes are at the heart of what we do	We anticipate market trends, we don't follow them	We fund before we lend and we control before we grow	We understand the part we play in identifying and escalating risks

### Risk appetite

Our risk appetite is set and approved annually by the Board. It provides a clear articulation of the level of risk we are prepared to accept in order to achieve our strategic objectives. It is expressed and embedded through:

- A 'high-level' Risk Appetite Statement that provides a concise set of key Bank-wide targets and limits, with a balance of current, forward-looking and stress-based metrics for financial and non-financial risks.
- 'Directional' risk appetite limits for each of the Bank's key risk types (e.g. retail credit risk, operational risk). These Directional limits are designed to provide early indications of changes in the operating environment and an outlook on whether we remain on-track to meet our 'high-level' risk appetite targets.

Performance against both the 'high-level' risk appetite and 'Directional' measures are monitored and reported to our Executive Risk Committee (ERC) on a monthly basis, and at each Board Risk Committee (BRC). Additionally, escalation processes are embedded to notify Senior Executives and Board members of any risk appetite measure operating outside of approved thresholds.

Our risk appetite enables us to make clear and transparent decisions on potential trade-offs between different aspects of our risk profile. In this way, strategic decisions are made in the full context of those factors likely to be of interest to a range of stakeholders. This enables us to understand the Bank's current and future risk profile, how it supports our strategic objectives and how it supports the best interests of our customers and other stakeholders.

### Risk policies and behaviours

We have identified a set of principal risk types to which we are exposed through our activities (see separate section below). Each risk type is actively managed through a key risk policy and supporting policy standards that clearly articulate the approach and boundaries by which the risks are managed and ensure everyone understands their individual responsibilities. The policies and policy standards set out the expected behaviours and requirements to support effective, agile and consistent decision-making across the Bank.

### Evidence of control

We adopt a process-centric approach to identifying, measuring and controlling our key risks, ensuring that attention is focused on what matters most. We undertake Process Risk and Control Assessments (PRCA) across all of our key activities to ensure that appropriate and effective controls are in place, and treatment plans are identified where strengthening is required. Key risk responsibilities are viewed through an enterprise-wide lens, which allows for greater ownership of top risks by subject matter experts. Each material risk is assessed on the basis of its inherent exposure, its residual exposure in the prevailing control environment and its target exposure if different from current residual levels. This process, whilst in operation, is one which continues to be refined and matured to ensure the organisation's control environment is operating within our risk appetite.

Our Business Enterprise Risk Tool (BERT) is used to record and manage our key processes, the controls we have in place, any treatment plans to improve our control environment and to record our management of risk events. All colleagues have access to BERT enabling them to view risk data across the organisation.

We continually look to improve our controls in line with industry best practice and the environment in which we operate.

### Reporting

Our risk reporting processes are critical to understanding the specific and aggregate levels of risk to which we are exposed and the effectiveness of our controls to manage these risks. We promote insightful reporting at all levels to encourage debate on what matters most, and to ensure effective action is being taken at an appropriate level to address any current or emerging areas of concern.

### Resilience plans and stress testing

Financial and Operational Resilience are key areas of focus. Our capital and liquidity adequacy are assessed on (at least) an annual basis through the ICAAP and ILAAP. Business recovery plans for severe incidents are reviewed on a regular basis, while our Recovery and Resolution Plans review our playbooks and recovery capacity in response to extreme but plausible threats to our viability.

### Risk management during COVID-19

The effectiveness of our resilience planning was evident in our response to the COVID-19 pandemic. Our crisis management team (CMT) was formally invoked in March and daily crisis management activity remained in place until October. Reporting packs were created using both existing and new MI to ensure focus on the most important issues as the situation evolved. The CMT was re-implemented in January due to the increased COVID-19 infection rates across the UK and the national lockdown and remains alert to any further changing circumstances that may impact the Bank.

### Risk management structure

We adopt a Three Lines of Defence framework to provide a basis for the identification and management of all risks associated to our business model and strategy. Within our Three Lines of Defence framework:

- **First Line.** Primary responsibility for the identification, management, monitoring and control of risks rests with our commercial and operational teams. The First Line teams, as subject matter experts, own the processes and controls used to manage risks within risk appetite and are responsible for the design, operation and testing of the key controls.
- **Second Line.** The independent Risk Management Division is responsible for providing risk frameworks, policies, guidance and oversight within which the First Line can manage its risks.
- **Third Line.** Our Internal Audit Division provides independent assurance on the effectiveness of risk management and internal control processes in mitigating and reporting risks.

### Argos Financial Services (AFS)

These financial statements present the standalone financial performance and position of Sainsbury's Bank and do not consolidate the AFS subsidiaries. However, the risks associated with AFS business are managed in line with the Group-wide risk framework, with a suite of risk appetite measures in place for AFS and tracked within the wider Group governance structure.

### Key uncertainties

We regularly monitor emerging and evolving changes in the risk environment in order to promote early discussion to understand and address any threats or opportunities to our business model. We consider specific emerging threats and opportunities under the following broad themes:

- **Strategic.** Reflects both our business model and the markets in which we operate. For example, regular consideration is given to changes in the competitive market resulting from new entrants or mergers and acquisitions (M&A) activity, and any resultant impact on margins.
- **Operational.** Reflects changes in technology, the impact of internal processes or emerging external best practices. For example, we continually review the evolving nature of cyber-crime and its impact on the Bank in terms of financial losses and operational costs to protect our customers.
- **Political and Economic.** Reflects the impact of macroeconomic conditions and government policy on our markets. For example, we continue to reflect the expected impact on UK market conditions arising from the COVID-19 pandemic and the impact of changes in interest rates, the employment market or house prices on the demand for our products.
- **Regulatory and Conduct.** Reflects continued developments within the financial services sector including PRA and FCA consultations and changes to Basel regulations. For example, the implementation of payment holidays as a result of the COVID-19 pandemic.

As more information is known about an emerging risk, it will be subject to a full risk assessment. Actions will then be taken to manage and control the risk, unless it is assessed as not relevant or not material to the Bank.

**COVID-19** has had a significant impact over the last year across all of the four themes noted above. The Bank responded initially from an operational perspective and deployed its business resilience plans and governance processes to ensure that both customers and colleagues were supported. The Bank also focused on managing its credit strategies as the pandemic evolved over the year and extensive support was given to the launch of emergency payment freezes to assist customers in managing their finances. Whilst the bad debt charge increased due to the impact of COVID-19, overall the Bank's portfolios remained robust and continued focus remains on detecting any signs of emerging deterioration. Our capital and liquidity ratios remain strong and we continue to assess possible sensitivities and stress outcomes to our plans to ensure we remain resilient.

**Climate change** is an emerging threat that potentially exposes the Bank to direct and indirect financial risks. In line with PRA guidance (SS3/19), we have developed a strategy to identify, assess and manage our exposure across the key areas of governance, risk management, scenario analysis and disclosure. The Bank remains on track to embed its approach to managing the financial risks from climate change by the end of 2021. A framework has been established to ensure appropriate visibility of the risks arising from climate change and our ICAAP includes an assessment of the impact of financial risks from climate change, including the impact of extreme weather on our ability to serve our customers.

## Principal risks

### Credit risk

#### What is it?

The risk that a retail customer fails to maintain their contractual obligations and repay their borrowing on time.

#### How may it arise?

Changes in the economic conditions in the UK may impact on the ability of our customers to repay their loans leading to an increase in levels of bad debt.

#### How do we manage the risk?

- We lend responsibly, considering the suitability of the product to meet our customers' needs and their ability to repay any debt.
- We have policies to support vulnerable customers and those in financial difficulties.
- Credit decisioning based on information from a number of credit related sources.
- Regular stress testing is undertaken using a variety of plausible stress scenarios.

#### Changes in 2020/21

- Key focus in the year was the response to COVID-19.
- Management of credit strategies as the pandemic evolved.
- Assisting with the launch of Emergency Payment Freezes.
- Supporting gradual restart of lending.

### Operational risk

#### What is it?

Losses or disruption resulting from inadequate or failed processes, people and systems or from external events.

#### How may it arise?

Inadequate processes or internal controls may result in poor customer outcomes, service disruption, reputational damage and/or financial losses.

#### How do we manage the risk?

- A process-centric approach to risk & control assessment, designed to focus on what matters most.
- A clear operating model to embed consistency and boost capability across the Bank.
- Aggregated reporting and insight on our risk profile to ensure the highest priority items are escalated.
- Monthly review of our Top Risks with a rolling agenda of deep-dives.

#### Changes in 2020/21

- Ensuring business resilience plans were operating effectively throughout the pandemic.
- Enhanced MI to manage a broad range of risks across the Bank.

### Supplier risk

#### What is it?

The risk that key services and processes outsourced to third-party suppliers impair the quality of internal control within the Bank.

#### How may it arise?

Inadequate processes or internal controls of the third-party supplier may result in poor customer outcomes, service disruption, reputational damage and/or financial losses for the Bank. This can also manifest through lack of appropriate review and diligence of the third party by the Bank.

#### How do we manage the risk?

The management of supplier risk takes place at two key times, which are reviewed and approved by the accountable Bank Executive:

- **During the selection of a new supplier**, with a robust assessment of the high-level process steps associated with the service provisions, the key failure points which could occur in the process, and an understanding of the key controls and appropriate provision of MI that evidences the effective operation of these key controls.
- **On an ongoing basis** as part of the Bank's operational risk management framework via the PRCA process as well as part of the regular monitoring of supplier performance (including the use of scorecards and other governance activity per the supply chain framework).

#### Changes in 2020/21

- Review of supply chain to ensure compliance with new European Banking Association Outsourcing guidelines.
- New workflow and contract management tool being implemented to enhance controls and compliance.
- We have maintained regular dialogue with our key suppliers and ensured we monitor for any supplier showing signs of stress as a result of COVID-19.

### Financial crime risk

#### What is it?

Our products are used to facilitate financial crime and/or our processes, systems or controls are non-compliant.

#### How may it arise?

Failure to protect our customers may lead to financial loss, inconvenience to our customers and result in regulatory censure and loss of confidence in the Bank.

#### How do we manage the risk?

- Prevention and detection processes, systems and controls in place.
- Proactive engagement with industry, sharing intelligence.
- Robust horizon scanning to identify and impact assess emerging threats.
- Money Laundering Reporting Officer provides regular reports on financial crime controls to Executive and Board committees.

#### Changes in 2020/21

- 2nd line oversight and assurance deep dive reviews in order to limit any potential fraud risk exposures.
- Improvements in fraud prevention capability.
- Ensuring fraud risk resiliency on the back of COVID-19.

## Conduct and compliance risks

### What is it?

The risk that our culture, behaviour or actions may lead to a failure to comply with regulators, or cause detriment to customers or the markets.

### How may it arise?

Failure to understand the needs of our customers or to provide them with the level of service required at all stages of the customer journey.

### How do we manage the risk?

- Control procedures and processes with clear reporting and escalation procedures.
- Independent oversight of the adequacy and effectiveness of issues and events.
- Horizon scanning of emerging threats or regulatory changes.
- Regular, open engagement with our regulators.
- Continuous monitoring of control testing outcomes through PRCA oversight and risk based assurance activity.

### Changes in 2020/21

- Finalised organisational redesign for the function with key roles now filled.
- Enhanced policy oversight model.
- Full implementation of SMCR, including Conduct rules, in AFS and Argos Limited.
- Enhanced risk reporting.

## Capital adequacy risk

### What is it?

Holding insufficient capital to absorb losses in normal and stressed conditions or the ineffective use of capital.

### How may it arise?

Changes in economic conditions or regulatory requirements may impact on the level of capital resources required.

### How do we manage the risk?

- Target risk appetite range for level of capital held.
- Monitoring of capital position, with triggers in place for escalation.
- Capital adequacy target built in to our planning processes.
- Projected capital position updated for any strategic or external changes.
- The annual ICAAP determines the adequacy of the level and type of capital resources held.

### Changes in 2020/21

- PS15/20 came into effect on 16 Dec 20 which implemented a shift in regulatory capital requirements from minimum Total Capital Requirements into buffers that can be used in a stress.
- The impacts of COVID-19 have been updated including expectation of higher losses. Furthermore stress testing analysis has been undertaken to assess worst case impacts.

## Liquidity, funding and market risks

### What is it?

The risk we are unable to meet our obligations as they fall due or are adversely hit by market rate or price movements.

### How may it arise?

Loss of confidence in the Bank leading to a material outflow of deposits and/or difficulties in accessing wholesale funding. Sudden changes or volatility in market values.

### How do we manage the risk?

- Risk appetite limits set.
- Daily monitoring and reporting of key metrics.
- Liquidity and funding targets built into planning process.
- Liquidity Contingency Plan for action under stress.
- Hedging strategies used to reduce exposures to earnings volatility.
- The annual ILAAP determines the adequacy of liquidity and funding resources held.

### Changes in 2020/21

- Replacement of secured funding facility with a cost effective retained securitisation (Drury Lane) which offers increased flexibility and reduced reliance on BoE facilities.
- Review and assessment of negative rates from a hedging and interest rate risk perspective.

## Wates Corporate Governance Principles

Sainsbury's Bank plc applies the Wates Corporate Governance Principles for Large Private Companies (available on the Financial Reporting Council website).

### Principle 1 – Purpose and Leadership

#### Purpose, values and culture

The Bank is aligned to the Sainsbury's Group strategic priority to focus on brands that deliver with a customer and profit focus whilst supporting the core food business. We aim to drive value for the Sainsbury's Group by being an agile, capital and cost-efficient provider of simple, mobile led financial services for Sainsbury's and Argos customers. We know that when customers take out a Bank product, they become more loyal and go on to spend more in Sainsbury's and Argos stores. The strategy and objectives were reviewed and updated by the Board in 2019, including the decision to cease new mortgage originations from September 2019.

Supporting this are the Bank's key priorities between now and 2024:

- Re-shape the Bank's balance sheet
- Simplify the organisation
- Strengthen the business

Underpinning those key priorities, the Bank sets a clear risk appetite to operate within and seeks to deliver best-in-class execution through highly engaged colleagues, working together to deliver its goals.

Details of the Bank's broader purpose in relation to non-financial matters (Environmental, Social, Employee, Human Rights and Modern Slavery, Anti-Corruption/Anti-Bribery) are provided on pages 11 to 13.

#### Strategy

The Board of Directors of the Bank is the key governance body, responsible for the overall strategy, performance of the business and management of risk. It delegates responsibility for the day to day running of the business to the Chief Executive and the Executive Management Team through the apportionment of responsibility and delegated authorities. The Board holds overall accountability for the outcomes achieved, decisions made and steering the Company, subject to specific reserved matters which require the consent of J Sainsbury plc.

Performance against key metrics is measured and reported to the Board and all colleagues on a regular basis. The metrics link together – as we believe that if we have highly engaged colleagues, who deliver a great service to our customers, this in turn will help us drive increased profitability and lower costs. As a financial services business in a highly regulated environment, we also need to ensure we are operating in a safe and sound way too.

#### Relationship with J Sainsbury plc

The Bank is a wholly owned subsidiary of J Sainsbury plc, a listed retailer. J Sainsbury plc currently has one Director on the Bank Board. The J Sainsbury plc appointed Director has equal rights and powers as the other Directors. J Sainsbury plc is not involved in the day-to-day management of the Bank. However, J Sainsbury plc has certain reserved powers and decisions which fall within those powers must be referred to them by the Bank Board for their consent before undertaking. Primarily, these reserved matters relate to significant change in the size and scale of the Bank's operations, changes in its capital structure including any increases or decreases to capital, significant individual contracts or legal disputes, changes to Directors or officers of the Bank and share schemes.

### Principle 2 – Board Composition

#### Chair

The Bank has a separate Chair (an Independent Non-Executive Director) and Chief Executive (an Executive Director) to ensure that the balance of responsibilities, accountabilities and decision making are effectively maintained. The Chair plays a key role in creating the conditions for overall Board and individual Director effectiveness.

### Balance and diversity

Recruitment on to the Bank Board combines an assessment of both technical capability and competency skills to ensure the optimum blend of individual and aggregate capability having regards to the Bank's long-term strategic plan. Such recruitment is subject to the approval of the Nominations Committee, the Bank Board, J Sainsbury plc (as the decision falls within reserved matters) and the relevant regulatory bodies (where applicable).

Independent Non-Executive Directors bring their experience to bear from across various sectors, notably Financial Services but also from across Retail, Digital and E-Commerce. These are key areas of focus for the Bank and aligned to its strategy. Directors update their skills, knowledge and familiarity with the Bank by meeting senior management, a programme of developmental training (from both internal and external speakers) and by attending appropriate external seminars. There is an induction programme for all new Directors which is tailored to their specific needs and which provides access to all parts of the business.

### Size and structure

The structure of the Bank Board seeks to ensure the right leadership is in place to become an agile, capital and cost-efficient provider of simple, mobile-led financial services to Sainsbury's and Argos customers.

The Bank Board is comprised of an Independent Chair, four other Independent Non-Executive Directors, one Non-Executive Director appointed by J Sainsbury plc and two Executive Directors – the Bank's Chief Executive Officer and its Chief Financial Officer. A biography for each Board Director can be found on the J Sainsbury plc corporate website: [www.about.sainsburys.co.uk/about-us/our-management#sainsburys-bank](http://www.about.sainsburys.co.uk/about-us/our-management#sainsburys-bank)

The Directors have equal voting rights when making decisions, except the Chair, who has a casting vote at the Bank Board. All Directors have access to the advice and services of the Company Secretary and may, if they wish, take professional advice at the Company's expense. Directors' duties are exercised through the Board and its sub-committees per the Governance structure on page 14. Each of these is chaired by one of the Independent Non-Executive Directors.

### Effectiveness

The Board last undertook a formal effectiveness review facilitated by an independent external advisor at the end of 2015 with an internally led review undertaken in 2018. The next independent review is scheduled for the first half of the financial year ending 28 February 2022.

### Principle 3 – Director Responsibilities

#### Accountability

Each Board Director has a clear understanding of their accountability and responsibilities via the Individual Accountability Regime which the Bank introduced in early 2016 and which has been regularly updated since then. Whilst Board oversight is always maintained, key decisions are made by the individuals and committees with the most appropriate knowledge and experience.

The Board had a programme of eight main meetings in 2020/21 and has nine planned for 2021/22. One of the Board meetings is usually set aside each year for strategic planning with the Executive Committee and key stakeholders from across the Bank, AFS and J Sainsbury plc as appropriate.

As part of their annual review, the Bank Chair undertakes a Fit and Proper Assessment and Attestation with each Board Director. The Senior Independent Non-Executive Director undertakes the same for the Bank Chair.

#### Conflicts of interest

Any potential conflicts of interest are identified and considered as part of the recruitment process for on-boarding new Directors on to the Bank Board. Where there are any concerns raised, they are considered by the Bank's Nominations Committee and again at the Board meeting when the recommendation is brought for approval.

Once in situ, should a Director be offered the opportunity to take up a position (Executive or Non-Executive), whilst retaining their role on the Bank Board, they are required to inform the Bank Chair and the Board would then be asked to confirm that no conflicts of interest existed or were perceived to exist before accepting the additional role. Where there are any potential conflicts, appropriate safeguards would be implemented.

#### Committees

The Board delegates authority for day-to-day management of the Company to the Chief Executive Officer who exercises this role via the Executive Committee which meets monthly. It is chaired by the Chief Executive and its membership is made up of the:

- Chief Executive Officer
- Chief Financial Officer
- Chief Risk Officer
- Conduct & Compliance Director
- Chief Operating Officer
- Customer Director – Sainsbury's Bank
- Customer Director – Argos Financial Services
- HR Director

Note: The Bank's Internal Audit Director is a permanent attendee at every meeting.

The Independent Non-Executive Directors are wholly independent in that they have no material business or relationships with the Company that might influence their independence or judgement. In addition, certain governance responsibilities are delegated to other Board Committees (Audit Committee, Board Risk Committee, Remuneration Committee and Nominations Committee). Membership of these committees is entirely made up of Non-Executive Directors of the Bank with members of the Bank's Executive team and other senior colleagues in attendance. These committees support effective decision making and independent challenge.

#### Integrity of information

The Board receives regular and timely information at its meeting on all key aspects of the business supported by a range of Key Performance Indicators (KPIs). The Bank's various functions prepare and maintain the integrity of this information in accordance with the Bank's risk management framework.

#### Principle 4 – Opportunity and Risk

##### Opportunity

The Board is responsible for the overall strategy and performance of the business and its management of risk. It undertakes a deep-dive review of the Bank's strategy on at least an annual basis, taking due account of changes in the operating environment and emerging risks and opportunities. This includes a review of long-term strategic opportunities, building upon the Bank's purpose and advantages from being part of the wider Sainsbury's Group.

##### Risk

The Board Risk Committee (BRC) provides the Board with a forward-looking view to anticipate future risks together with the monitoring and oversight over existing risks within the risk appetite set by the Board. It is responsible for reviewing and reporting its conclusions to the Board on the Bank's risk appetite and the Bank's risk management framework. The BRC meets at least five times a year.

##### Responsibilities

In line with the provisions of the Senior Manager & Certification Regime (SMCR), the Bank has allocated the Senior Manager Functions and prescribed responsibilities in so far as they apply to Sainsbury's Bank plc and its AFS subsidiaries. A Management Responsibility Map (MRM) is in place to provide a description of the Bank's management and governance arrangements including the reporting lines and details of the individuals who are part of those arrangements and their prescribed responsibilities. The MRM is owned by the Board which reviews it at least twice a year.

The Bank has embedded a process-centric approach to identifying, measuring and controlling its key risks. It focuses attention on what matters most, those risks that can cause the greatest harm to our customers, reputation or finances. It provides a view on inherent risk, control effectiveness and residual risk assessments. It informs a bi-annual attestation of control effectiveness that is reviewed by the Board.

#### Principle 5 – Remuneration

##### Setting remuneration

The Board-level Remuneration Committee (RemCo) recommends to the Board the remuneration strategy for the Executive Directors, Chair, Senior Management and Material Risk Takers. Within this framework, its remuneration policy is aligned to the long-term success of the Company as well as promoting effective risk management and compliance with applicable statutory and regulatory requirements. RemCo also has oversight over appointment and severance terms for relevant employees.

##### Policies

A review is carried out annually (with input from external advisors) to ensure that the remuneration policy and practices are industry competitive and in line with the size and complexity of the business and compliant with all applicable legal and regulatory requirements. The policy also sets out the approach which ensures that reward decisions are objective, fair and inclusive.

The Directors' positions and remuneration status are set out in the Directors' Report (page 21).

##### Delegating remuneration decisions

Remuneration decisions are delegated through the divisional heads to agree fair and appropriate distribution of reward based on the principles agreed by RemCo and the performances of individuals across the business.

##### Subsidiary companies

The remuneration strategy and policies set by RemCo are fully applied to Argos Financial Services.

#### Principle 6 – Stakeholder Relationships and Engagement

##### External impacts

The Board is committed to social responsibility, community engagement and environmental sustainability. These goals are achieved through a combination of activities and commitments, including measures to support the Sainsbury's Group target to achieve Net Zero emissions from its operations by 2040.

##### Stakeholders

The Board promotes good conduct, accountability and transparency with all of the Bank's key stakeholders (customers, colleagues, investors, suppliers and banking regulators). Key interactions with each stakeholder group are set out in the section 172 statement on page 11. The Board sets a clear 'tone from the top' in line with the Bank's purpose to be the provider of financial services for loyal Sainsbury's Group customers.

##### Workforce

The Bank aims to be a great place to work for all colleagues, enabling them to develop their skills and knowledge to be the best they can be. Colleagues are encouraged to learn from each other, their managers and through structured learning activity that develops behavioural and technical capability. Cornerstones of our approach include investing time in two-way communication between leaders and other colleagues (informing and listening) and up-skilling leaders to be effective communicators and leaders of people.

Investors in People (IIP) award accreditation to organisations who invest in training and development. Sainsbury's has a long-standing relationship with IIP and has been awarded Gold in its last four assessments. The latest assessment which took place in 2019 included the Bank for the first time.

Whistleblowing is an important part of protecting the Bank as it creates a safe way for colleagues to raise any concerns and challenge poor practice and/or behaviour. The Bank's whistleblowing policy sets out how colleagues can report concerns internally, through the Group's 'Rightline' service or through regulators.

## Section 172

The Board fully recognises its obligations under the Companies Act 2006, including those set out in section 172. Its governance framework and regular programme of agenda items ensures it has due regard to:

- **The likely longer-term consequences of its decisions.** For example, the Board approves a rolling five-year strategic plan on an annual basis and regularly monitors its progress through key metrics (which form the basis of KPIs outlined on page 16) and sub-committees to provide appropriate review, balanced challenge and transparency on decision making.
- **Maintaining the reputation of the Bank (and the Sainsbury's Group brands it uses) for high standards of business conduct.** The Board promotes the values of the wider Sainsbury's Group across the organisation. These values help colleagues to know how to act at work and we believe they're right because they're also the way that many of us live outside of work too. Sainsbury's Group (including the Bank) has always had a strong sense of social, environmental and economic responsibility and an understanding that our success depends on society's success. Further details on our approach to diversity, environmental and social factors are outlined in the Non-financial reporting section on page 13.
- **The views and interests of its key stakeholders.** The Board seeks to understand the views of key stakeholders in order to inform effective decision-making and to deliver long-term success. It identifies our core stakeholders as: customers and communities; colleagues; investors; suppliers; and regulators. The interaction with each stakeholder group is set out in the following section.

By taking regard of these factors, the Board seeks to ensure that the Directors have acted both individually and collectively in a way that would, in good faith, be considered likely to promote the success of the Bank while having due regard to all its stakeholders and to the matters set out in paragraphs a to f of section 172 of the Companies Act 2006.

## Key stakeholders

### Customers and Communities

Here at Sainsbury's Bank we recognise that money influences all areas of our customers' lives. Whether it's during their daily commute to work or in planning a holiday with their family, we know how important saving money and savvy spending is to them.

We're currently working on a new customer strategy that makes best use of our data and insight to ensure we speak to our customers about relevant topics, at the right time and through the right channels. We consider not only acquiring new customers, but also how best to retain and reward those already with us. We plan out customer journeys, with engaging, personalised content, overlaid by targeted communications when the time is right.

Our customers inspire our content – from money-saving ideas, to tips for looking after a new puppy or earning more Nectar points on their credit card. All topics we hope will inform and engage them, encouraging them to stick with us and consider us for any financial services needs in the future.

Customer satisfaction is measured through Net Promoter Score (NPS) and by capturing online and telephone feedback and is reported to the Board. Findings are used to improve our customers' experience and engagement with knowledge being shared across all of our business. We also have a clear process for responding to customer complaints and any key themes that are identified are reviewed by the Board and senior management and discussed with our regulators.

The Sainsbury's Group Values and Sustainability Plan underpin our approach to what we do, and how. By acting in the best interests of all our stakeholders, we can make a sustainable and positive contribution to our community. We also know that playing an active and supportive role in our community is really important to our colleagues. It makes us all feel good to know we're doing something for someone else.

In 2020/21, our colleagues raised over £30k for Maggie's who help to provide free, practical, emotional and social support to people with cancer and over £3k for Refuge who provide high quality services for women and children who have experienced domestic violence to protect and prevent against future violence through education, training and awareness-raising. We also support the fund-raising activities that Sainsbury's does each year, including Comic and Sport Relief, with the Bank donating £40k to Comic Relief.

### Colleagues

We aim to make our Bank a great place to work for all colleagues. Our 'Great Place to Work Group' is part of the Group-wide approach, enabling colleagues' voices to be heard and providing an effective way to communicate what matters to our colleagues to make a difference in our business. This is also mirrored in our Wellbeing Champions and Inclusion Working Group members.

We want our colleagues to develop their skills and knowledge to reach their potential, learning from each other, their managers and through structured learning activity that develops behavioural, professional, technical and regulatory capability. How it feels to work at our Bank makes us different because our Values guide everything we do. Cornerstones of our approach include investing time in two-way communication between leaders and other colleagues – informing and listening – and building trust through clear accountabilities and leadership. We check in with our colleagues regularly to gather their feedback on what we do well and how we can improve how it feels to work for the Bank. Our 'We're Listening' surveys focus on sustainable engagement to understand the strength of connection our colleagues have to our business and brand over the long term. The results of these surveys are discussed by the Board.

We are committed to an equal opportunities policy for recruitment and selection, through training and development and to performance reviews and promotion. As part of the Sainsbury's Group, the Bank supports the Group's vision to become the 'most inclusive' retailer by embracing our differences across the Bank. The activities we're undertaking to be a more diverse and inclusive organisation are fundamentally about fairness and equality. A balanced workforce at all levels improves culture, behaviours, outcomes, profitability and productivity. With this diversity comes a variety of ideas and views that inform decision-making and enable us to understand our customers better.

As part of Sainsbury's Group, the Bank has well developed policies for the fair and equal treatment of all colleagues. During the year, a number of mandatory e-learning modules have been developed to ensure that our policies are understood throughout the organisation. We have a workplace adjustments process in place for our colleagues who are living with a disability or long-term health condition which operates through the Government's Access to Work scheme. Workplace adjustments can be made at any point during a colleague's employment with us.

The Bank offers a comprehensive and competitive total reward package. In support of the wider objectives of J Sainsbury plc, our colleagues are encouraged to participate in two all-employee share plans, namely the Savings-Related Share Option Plan ('Sharesave') and the All-Employee Share Ownership Plan, of which the Sainsbury's Share Purchase Plan ('SSPP') is a part.

In response to colleague feedback, the Bank and Group have worked together to put an affordable colleague loan scheme in place with third party Salary Finance. Salary Finance take loan repayments directly from colleagues' pay via payroll. This means loan interest rates are often lower and a wider range of criteria can be used than most lenders when reviewing and approving loan applications. Colleagues' applications are assessed to make sure the loan is appropriate and affordable for them.

### Investors

J Sainsbury plc owns 100% of our equity capital and we also have debt investors through our Tier 2 capital issuance. Our Board sets our risk appetite to support and protect investor value and to ensure we operate within appropriate and agreed levels and types of risks.

Our strategic aim is to be the provider of financial services for loyal Sainsbury's Group customers. The Group's interests are represented by an appointed Non-Executive Director to ensure effective challenge and collaboration to grow our connected services. Where interests are not aligned, this is managed through disclosure and activities to minimise potential conflicts.

### Suppliers

Our Board understands the importance of our supply chain in delivering our plans and the long-term success of the business. We seek a strong degree of engagement with third-party suppliers across the end-to-end supplier management process, from sourcing to procurement to relationship management to contract reviews. We recognise that when we outsource a service, we do not outsource the responsibility. We ensure our suppliers are compliant with regulatory requirements and have the necessary controls in place in line with risks to make sure we continue to meet a high standard of conduct for our customers. Our Supply Chain Oversight Committee provides performance oversight of our suppliers and reports to senior management and the Board.

Continuous and proactive collaboration with our suppliers is undertaken on a regular basis. This provides a forum for developing the business relationship and to ensure we receive an effective service, identify and manage risk appropriately and operate in line with our values. A key factor in building effective relationships with our suppliers is ensuring our requirements are clear and that they are paid on time. The Bank's iSupplier internet portal provides suppliers with access to the purchase orders raised and allows them to allocate their respective invoices once they have fulfilled the order requirements.

### Regulators

We are regulated by the Prudential Regulation Authority for prudential issues and by the Financial Conduct Authority for conduct of business matters. We engage with regulators on an open and proactive basis, ensuring full compliance with the letter and spirit of the rules we operate within.

We recognise the trust that customers place in the Sainsbury and Argos brands and seek to maintain that by operating in a safe and sound way. Our Head of Conduct and Compliance provides oversight of any emerging compliance risks and reports any areas of concern to the Board.

### Key strategic decisions

**Response to COVID-19** – The Bank moved quickly at the start of the COVID-19 pandemic to support existing customers in terms of Emergency Payment Freeze capability and took necessary steps to ensure Credit Risk policy was adopted to mitigate potential impacts linked to the market stress.

To make it as easy as possible for customers and to minimise call volumes coming into our contact centres, we set up an online form that customers could complete with their payment freeze request. We also published information on our website and emailed our customers to make them aware of the options available to them. Our contact centre staff played a critical role in managing the customer experience to ensure each case was treated on an individual basis to ensure the right outcome was achieved.

We held regular calls with the FCA and PRA to talk about our operational resilience, our financial resilience and our treatment of our customers. The FCA was particularly focused on our treatment of vulnerable customers and how we made sure that we knew who they were and that we continued to support them in the right way. Our meetings were constructive and helpful, with the regulators also providing their insights on what they expected from us and what they were seeing across the wider industry. The Payment Services Regulator was also in communication with us about our ATM estate and ensuring access to cash.

**Travel Money** – Lockdown began at the beginning of the financial year which impacted the entire travel market, resulting in the closure of our Travel Money business. Travel Money colleagues from closed Bureaux were redeployed into Sainsbury's supermarkets to support our Sainsbury's store colleagues when it was needed most. As part of J Sainsbury's, the Bank has been working closely with the relevant authorities and plans have been put in place to make sure we protect colleagues. Regular colleague communications have been sent throughout the year to update on the different lockdown restrictions across the United Kingdom and the impact this has had on our ways of working, and a dedicated COVID-19 response page has been set up on the Group intranet for all colleagues to access.

**Digital transformation** – Throughout the year, we have been making great progress in making our customer experience easier and strengthening our business with a lower-cost customer proposition through numerous digital developments. This is aligned to our objective to be an agile, capital and cost-efficient provider of simple, mobile-led financial services.

- Working with Google we introduced Google Pay Wallet for our credit card customers. This means that our customers are now able to add their Sainsbury's Bank Credit Card to their Google Pay Wallet which enables them to make in-app and tap-to-pay purchases on their Android phones, tablets or watches.
- A key milestone as part of our digital strategy is investment in our Loans and Savings application journey, speeding up and streamlining the process for customers. Once live, they will be able to use their mobile phones to complete our required checks. Accounts are set up quicker, and loan funds are delivered sooner.
- Our Car & Home Insurance customers can now pay online, see Nectar offers as part of the sales journey and they can 'Live Chat', allowing customers to get quick and easy assistance when required.

Our significant effort to improve digital has allowed us to engage with our customers more effectively through digital channels. As a result, we have seen a 20% year on year increase in the share of all Bank site traffic coming from mobile devices, which has allowed us to expand our digital marketing channels, with 90% of all applicants now starting digitally. This also contributes to the Group's environmental targets, with 70% of customers now receiving paperless statements.

**Drury Lane Securitisation** – The Bank launched a secured funding programme in November 2020, the Drury Lane Personal Loans Securitisation, that created £500 million of tradeable debt securities backed by unsecured personal loans. The securities were retained by the Bank, and represent AAA-rated collateral that can be used to borrow funds in the debt capital markets or, once the securities are approved, from the Bank of England.

The transaction further improves our already strong liquidity position in line with our core strategic priority to strengthen the Bank. It facilitates the diversification of funding sources, creates contingent funding options and reduces the Bank's reliance on Bank of England funding schemes. The transaction was structured to comply with Simplified, Transparent and Standardise (STS) requirements and all relevant Securitisation Regulation.

Although not a reserved matter, we kept the J Sainsbury plc Board informed of the intention to issue the transaction. The transaction was also reviewed with our regulator as part of the ILAAP and Corporate Plan ahead of the transaction commencement.

**Supplier relationships** – The Bank has always performed financial health monitoring of our suppliers and since the onset of COVID-19, we have maintained regular dialogue with our key suppliers and ensured we monitor for any supplier showing signs of stress. The majority of the Bank's suppliers have payment terms of 30 days from date of receipt of invoice, with some being aligned to J Sainsbury's terms of 45 or 60 days. As a result of our monitoring and our relatively favourable 30 day terms, we decided not to reduce our payment terms across the suppliers, nor did we receive any requests from suppliers to reduce them.

## Non-financial reporting

The Bank has complied with the EU non-financial reporting directive requirements contained in sections 414CA and 414CB of the Companies Act 2006. The below disclosures are intended to help stakeholders understand the Bank's position on key non-financial matters.

### Business model

The Bank seeks to provide quality financial services to Sainsbury's and Argos customers at an affordable price. The business model is outlined on page 1 of this Strategic Report.

### Environmental

We are always looking for ways to manage the impact our operations have on our environment and are part of the Sainsbury's commitment to become a Net Zero operation by 2040. As part of Sainsbury's, our facilities management approach actively manages, and looks to continuously improve, our waste management and recycling. We use video and telephone conferencing facilities rather than travel to meetings, where possible. Colleagues are encouraged to use public transport and cycle to work, with shower facilities provided at our head office and larger sites. We take time to identify practical ways to reduce the environmental impact of our leaflets and Point of Sale materials in stores.

Additionally, we have invested in digital capabilities reflecting the increasingly digital world our customers live in. This investment continues to drive more sustainable banking. For example, our Loans platform affords the Bank the ability to offer e-signatures thus removing the requirement to both generate and send physical Personal Loan documentation. Our Credit Card app also offers the ability to check your balance and get paperless statements, thus reducing the amount of physical paper statements being sent to customers.

### Social

The Sainsbury's Group Values and Sustainability Plan underpin our approach to what we do, and how. By acting in the best interests of all our stakeholders, we can make a sustainable and positive contribution to our community. Details on our interaction with our communities are outlined on page 11.

### Our customers

Here at Sainsbury's Bank we recognise that money influences all areas of our customers' lives. Our approach to our customers is outlined on page 11.

### Employees

We aim to make our Bank a great place to work for all colleagues. Our approach to make our Bank a great place to work is outlined on page 11.

### Gender pay gap

Details of the Bank's gender pay gap can be found within the Sainsbury's Group disclosures at <https://www.about.sainsburys.co.uk/~media/Files/S/Sainsburys/Gender%20Ethnicity%20Pay%20Gap%20Report%202020.pdf>

The mean gender pay gap of 36.6% (as at April 2020) has marginally increased from 35.9% in April 2019. The gap is, in part, reflective of the structure of our business whereby in store Travel Money Bureaux colleagues are directly employed rather than filling our positions through a third-party agency. Around 45% of Sainsbury's Bank colleagues work in these roles on hourly rates of pay and a large proportion of these roles are held by women. In addition to the Travel Money colleague composition, Sainsbury's Bank still has more men than women in the most senior and higher paid roles and more women in hourly paid positions, further impacting the pay gap.

We are continuing to see an improvement in female representation at senior levels since signing up to the Women in Finance Charter (WIF) in 2018. The Charter, which was created by HM Treasury, is designed to support and motivate finance companies to land activity and drive initiatives that, over time, will help address gender imbalance at senior leadership levels. By the end of the 2023/24 financial year we have a target to achieve 40% female representation at senior levels, with an interim target of 35% for the coming 2021/22 financial year. Our most recent WIF submission in September 2020 was 33%, up from 29% in September 2019.

### Human rights and modern slavery

Sainsbury's Bank has a zero tolerance towards modern slavery and human trafficking. We are committed to acting ethically and with integrity in all of our business relationships. We will work closely with our business partners, suppliers and supply chains to ensure there is no place for modern slavery and human trafficking in any area of our business. We will regularly review our processes and controls to prevent modern slavery and human trafficking.

Our policies and procedures support and encourage colleagues to raise concerns relating to modern slavery or the presence of it in our supply chain at the earliest opportunity. Our full Modern Slavery statement is published on the Bank's website (<https://www.sainsburysbank.co.uk/~media/files/pdf/modern-slavery-statement.pdf>).

### Anti-corruption/anti-bribery

As a financial services provider, the Bank is exposed to the risk of facilitating bribery or aiding corruption through the provision of financial services. This risk is managed through a clear set of policies, procedures and controls which are communicated to colleagues through regular mandatory training modules including Anti-Bribery and Corruption, Anti-Money Laundering, Conduct Rules, Conflicts of Interest and Whistleblowing. The training material is reviewed and updated to reflect changes in legislation or best practice (e.g. tailored senior management training). The Supply Chain Management team regularly monitors suppliers to ensure that processes and controls are in line with the Bank's required standards.

**Governance**

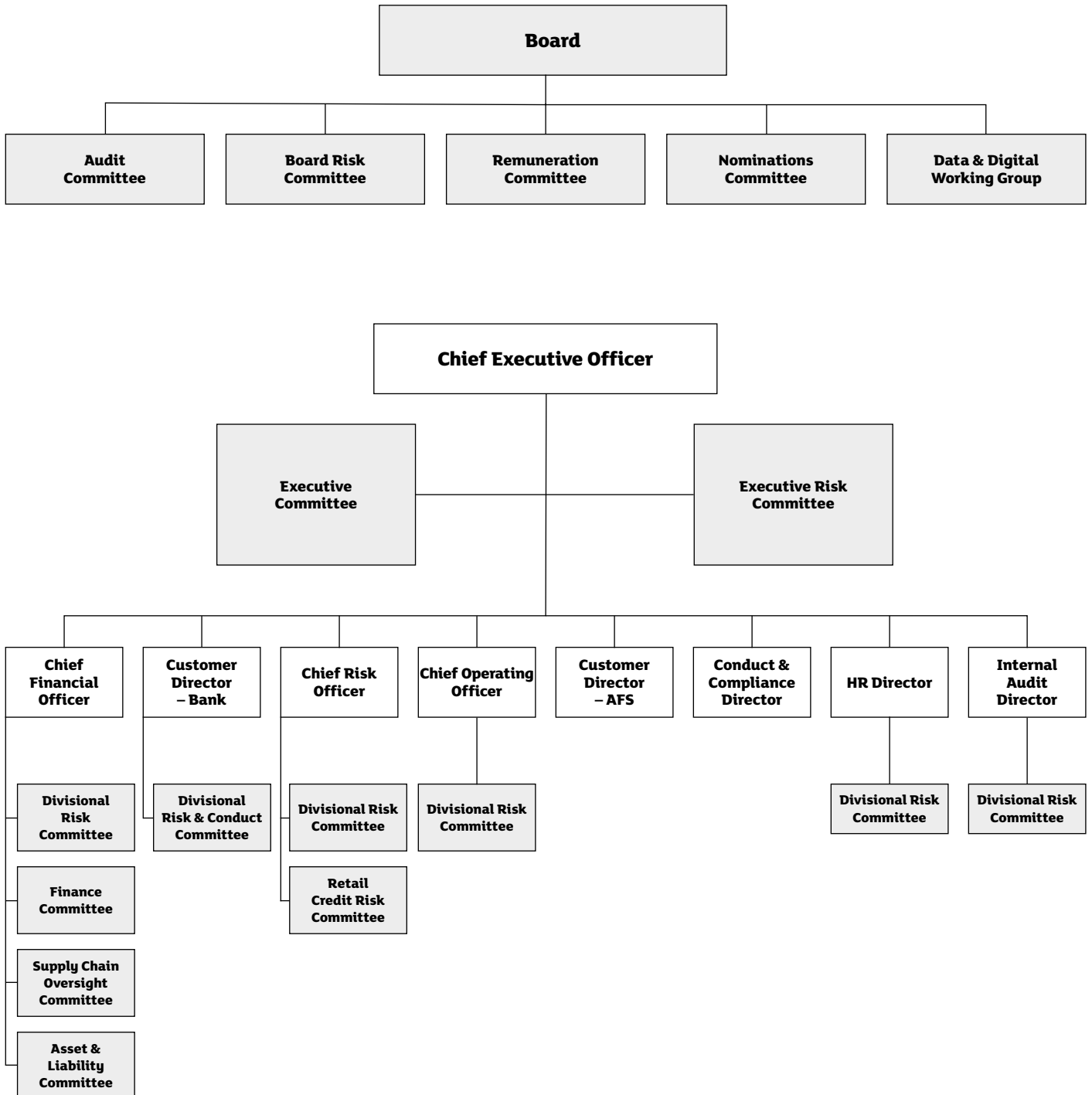
The diagram below shows the governance structure in place for Sainsbury's Bank as at 28 February 2021:

There were the following significant changes to our governance structure during the accounting period:

- The Customer Conduct Committee and Product and Pricing Committees were merged with the Customer Divisional Risk Committee to form the Divisional Risk & Conduct Committee shown in the diagram below.
- The Operational, Conduct and Financial Crime Risk Committee was stood down as its purpose and responsibilities were deemed to be adequately covered elsewhere, outside of this particular committee. The MI and reports that were previously tabled at this committee are now all tabled at the respective Divisional Risk Committees, with a clear line of sight from there into the aggregated report at the Executive Risk Committee, including the divisional and Top Risk profiles.

**Board-level governance**

The Board is the key governance body, holding overall accountability for the decisions made and outcomes achieved by the Bank, subject to specific reserved matters that require the consent of J Sainsbury plc. The Board meets at least eight times a year and is comprised of an Independent Non-Executive Chair, other Independent Non-Executive Directors, Non-Executive Directors from J Sainsbury plc and key Executive members from the Bank. Further details on the Board composition may be found on page 21.



A number of Board functions are delegated to four key sub-committees. The role and scope of authority for each sub-committee is fully outlined in a documented Terms of Reference:

- **Audit Committee.** The Audit Committee's key responsibility is to advise the Board on the Bank's financial statements, including systems and controls and related policy issues together with relationships with external auditors. The Audit Committee also reviews and challenges where necessary management's response to any major External or Internal Audit recommendations. The Committee is also responsible for reviewing and approving the internal audit plan and budget, and for ensuring that the function is adequately resourced. The Audit Committee meets at least four times a year. At least once a year the Audit Committee will meet without Executive Management being present. Additionally, the Audit Committee will meet with the External Auditors and Sainsbury's Bank Director of Internal Audit.
- **Nominations Committee.** The Nominations Committee is responsible for reviewing the structure, size and composition of the Board. The Committee is also responsible for the succession planning of the Board and the Executive Management Team and for ensuring a formal, rigorous and transparent process for recommending appointments to the Board to the Bank's shareholders. The Bank recognises the benefits of achieving a diverse Board and Executive Management Team to reflect the environment in which it operates. The Nominations Committee will meet at least once per year, with additional meetings convened as required.
- **Remuneration Committee.** The role of the Remuneration Committee (RemCo) is to determine and agree with the Board the broad policy for remuneration and for compliance with the Remuneration Code (the Code) to the extent that the provisions apply to the Bank. RemCo is responsible for recommending, monitoring and noting the level and structure of remuneration for senior management (categorised as 'Code Staff' for the purposes of the Code) and senior risk management and compliance colleagues and it continually reviews and assesses the impact of remuneration policies on the risk profile of the Bank and employee behaviour. RemCo also has oversight over appointment and severance terms for relevant employees. The Remuneration Committee meets at least three times per year.
- **Board Risk Committee.** The Board Risk Committee (BRC) provides the Board with a forward-looking view to anticipate future risks together with the monitoring and oversight over existing risks within the risk appetite set by the Board. It is responsible for reviewing and reporting its conclusions to the Board on the Bank's risk appetite and the Bank's risk management framework. The Board Risk Committee meets at least five times a year.

#### Executive-level governance

The Board delegates the appropriate responsibility, authority and accountability to the Chief Executive Officer (CEO) to deliver the Bank's strategy through the appropriate governance committees and the Executive Committee. The CEO chairs the Executive Committee (ExCo) and is supported by a number of other executive-level committees to provide the appropriate checks, balances and transparency on decision making.

Each committee has a documented Terms of Reference, with delegated authority to the Chair who is the appropriate identified accountable individual in line with their Statement of Responsibilities under FCA and PRA rules (Senior Manager Regime).

#### CEO Executive Committee:

- **Executive Committee (ExCo).** The role of the Committee is to advise and assist the CEO in overseeing the Bank's activities, performance and making significant decisions relating to the executive management of the Bank. ExCo meets on a monthly basis.

#### Chief Risk Officer (CRO) Executive Committees:

- **Executive Risk Committee (ERC).** The ERC is responsible for ensuring that the Enterprise Wide Risk Management Framework (EWRMF) is effective in ensuring that risks are adequately and consistently managed within risk appetite. In doing so the ERC ensures that appropriate policies and methodologies are in place to manage the Bank's Primary Risk types. The ERC meets on a monthly basis.
- **Retail Credit Risk Committee (RCRC).** The RCRC is responsible for monitoring the performance of the retail lending book, ensuring there is an effective credit risk management framework and that the Bank is operating within its credit risk appetite. The RCRC meets on a monthly basis.

#### CFO Executive Committees:

- **Asset and Liability Committee (ALCo).** ALCo is responsible for ensuring the balance sheet of the Bank is managed effectively and within risk appetite. Its main areas of responsibility are market risk, wholesale credit risk, interest rate risk, liquidity & funding risk and capital adequacy. ALCo meets on a monthly basis.
- **Finance Committee.** The role of the committee is to ensure there are effective levels of governance in place across the Bank's finance function so that significant decisions are fully informed, transparent, recorded and reported and in line with risk appetite and relevant governance structures. The Finance Committee meets on a monthly basis.
- **Supply Chain Oversight Committee.** The role of the committee is to ensure there is an effective bank-wide supply chain performance and risk management framework that manages outsourcing, oversees delivery and makes decisions to ensure the Bank is able to robustly manage and oversee its suppliers. The Supply Chain Committee meets six times a year.

#### Divisional Risk Committees

Each division across the Bank has its own Divisional Risk Committee (DRC) chaired by the relevant ExCo member. The role of the DRC is to ensure the effectiveness of the EWRMF within the Division, so that risks are effectively and consistently managed within the overall approved risk appetite. Each DRC provides input on material risks which may affect the Group to the Executive Risk Committee.

#### Pillar 3 report

Further information on the risks and controls can be found in the Bank's Pillar 3 Disclosure Report for the year ended 28 February 2021. This report is published in the investor relations section of the J Sainsbury plc corporate website: <https://www.about.sainsburys.co.uk/investors/results-reports-and-presentations#2021>.

## Key performance indicators (KPIs)

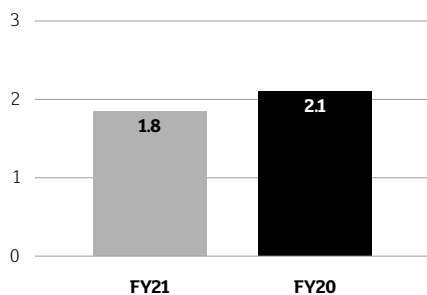
### Customer

To be the provider of financial services for loyal Sainsbury's Group customers, delivered through simple mobile led customer journeys.

#### Active customer numbers

*Definition:* The number of customers who hold an active account (savings/loans/credit card/insurance policy).

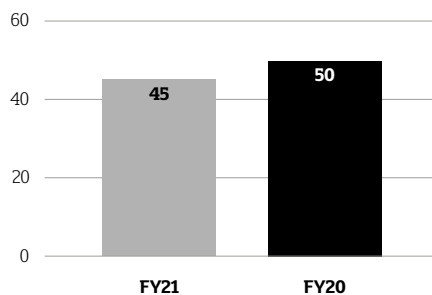
#### Active customers (million)



#### Net promoter score

*Definition:* Proportion of customers who have completed a transaction classed as 'promoters' net of 'detractors' when considering the likelihood of recommending the Bank to a friend.

#### Net promoter score (%)



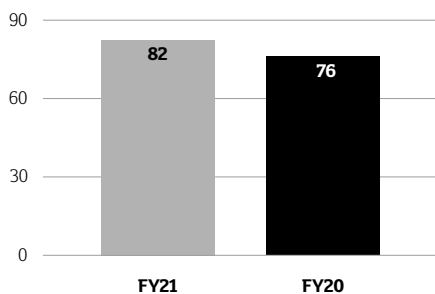
### Colleague

Continue to focus on an outstanding and engaged team.

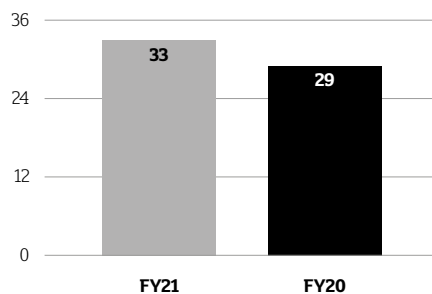
#### Sustainable engagement

*Definition:* Measures the strength of colleagues' connection to the Sainsbury's Group. Includes AFS.

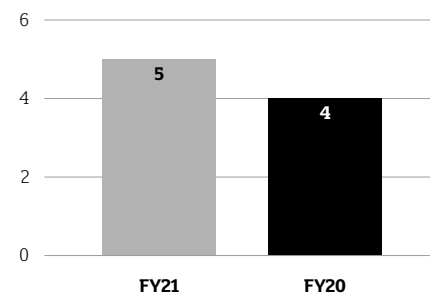
#### Sustainable engagement (%)



#### Females in senior roles (%)



#### BAME in senior roles (%)



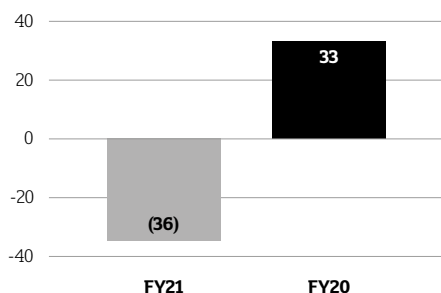
### Financial

Deliver the financial plan.

#### Underlying profit before tax

*Definition:* Profit before tax before any one-off items that are material and infrequent in nature.

#### Underlying profit before tax (£'m)



#### Return on capital employed

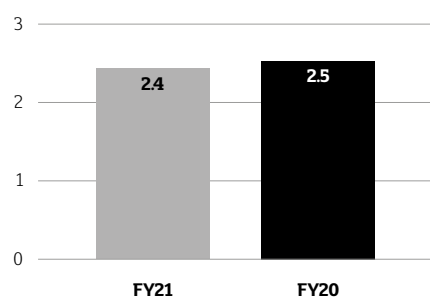
*Definition:* Underlying profit after tax divided by average equity.

#### Return on capital employed (%)

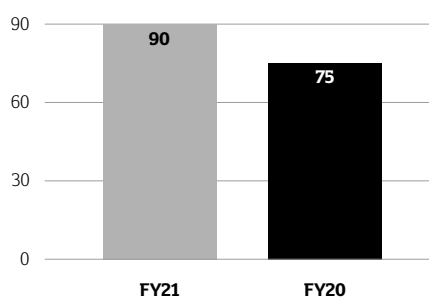


**Financial (continued)****Net interest margin**

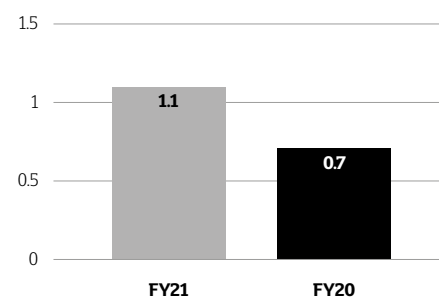
*Definition:* Income as a percentage of average interest-bearing assets.

**Net interest margin (%)****Cost income ratio (underlying)**

*Definition:* Underlying operating expenses as a percentage of total income.

**Cost income ratio (%)****Bad debt asset ratio**

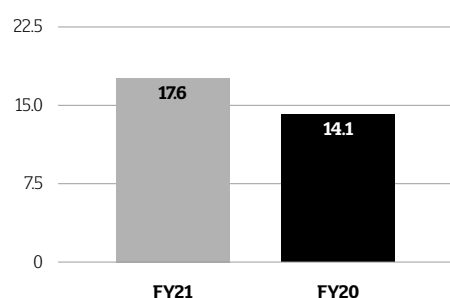
*Definition:* Impairment losses as a percentage of the average balance of loans and advances to customers.

**Bad debt asset ratio (%)****Safe and sound**

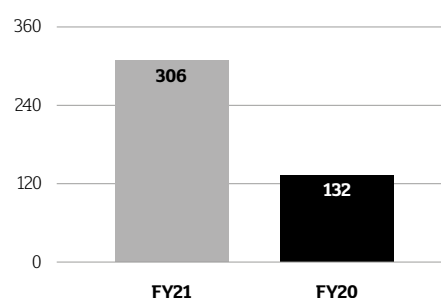
Manage the business within risk appetite.

**Tier 1 capital ratio**

*Definition:* Tier 1 capital as a percentage of risk-weighted assets.

**Tier 1 capital ratio (%)****Liquidity coverage ratio**

*Definition:* Percentage of the stock of high liquid assets such as cash to net cash out flow over a 30-day period.

**Liquidity coverage ratio (%)**

Our performance, including reference to the above KPIs, is further outlined in the Business review on page 3 and the Financial review on page 18.

## Financial review

The Bank's performance for the year ended 28 February 2021 and financial position at the end of that period are presented in the income statement and balance sheet. A summarised income statement and balance sheet are presented below:

	2021 £m	2020 £m	Change %
<b>Summary income statement</b>			
<b>Total income</b>	<b>221</b>	323	(32)
Operating expenses	(326)	(268)	22
Add: items excluded from underlying results <sup>1</sup>	126	25	404
<b>Underlying operating expenses</b>	<b>(200)</b>	(243)	(18)
Impairment losses on financial assets	(58)	(48)	21
Profit/(Loss) on financial instruments	1	(2)	(150)
Add: items excluded from underlying results <sup>1</sup>	–	3	(100)
<b>Underlying gains on financial instruments</b>	<b>1</b>	1	–
<b>Underlying profit before taxation</b>	<b>(36)</b>	33	(209)
<b>Statutory profit/(loss) before taxation</b>	<b>(162)</b>	5	(3,340)

<sup>1</sup> Items of an unusual and infrequent nature that do not relate to the Bank's underlying performance have been excluded in presenting underlying profit before tax.

Statutory loss before tax for the year ended 28 February 2021 was £162 million compared to a profit of £5 million in the prior year. This was driven by a 209% decrease in underlying profit due to the significant impacts of COVID-19 on income and impairments and an increase in non-underlying operating expenses of 404%, predominantly driven by the write down of fixed assets following the review carried out in the year of the Bank's capitalised assets.

Income is 32% lower, with a fall in interest income reflecting a significant contraction in lending balances of 29% due to lower consumer demand, lower retail spend and a tightening of credit appetite for new customers to protect the Bank, partially offset by management action on savings rates to manage the balance sheet. Fee income has dropped markedly due to the closure of Travel Money Bureaux for most of the year, and a decline in ATM income due to lower cash usage, particularly during lockdown.

Underlying costs decreased by 18% reflective of lower trading volumes and cost savings being delivered through management actions including reducing FTE, digitising and improving customer journeys and enhanced detection controls reducing fraud costs. Impairment losses increased by 21% which is reflective of prudent provisioning estimates during the current economic climate.

	2021 £m	2020 £m	Change %
<b>Summary balance sheet</b>			
Loans and advances to customers	4,599	6,511	(29)
Cash and cash equivalents	1,028	572	80
Other	1,811	2,319	(22)
<b>Total assets</b>	<b>7,438</b>	9,402	(21)
Customer deposits	5,128	6,312	(19)
Wholesale funds	1,161	1,781	(35)
Subordinated debt	179	180	(1)
Other	121	129	(6)
<b>Total liabilities</b>	<b>6,589</b>	8,402	(22)
<b>Net assets</b>	<b>849</b>	1,000	(15)

In balance sheet terms, our Loans advances reduced by 28% and our Credit Cards advances by 27% as market demand reduced and management took action to protect the Bank against economic uncertainty. Mortgage balances have steadily reduced throughout the year, with balances ending the year at £1.3 billion.

Customer deposits decreased 19% driven by careful management of the customer savings rates (spot rates declined 74 bps from February 2020) following the Bank of England base rate decrease in March 2020.

J Sainsbury plc provided no further share capital injections in line with Bank strategy.

### Net interest income

	2021 £m	2020 £m	Change %
<b>Net interest income summary</b>			
Interest receivable (underlying)	241	304	(21)
Interest payable	(81)	(115)	(30)
<b>Net interest income (underlying)</b>	<b>160</b>	189	(15)
<b>Net interest margin (underlying)</b>	<b>2.4%</b>	2.5%	(0.1)

	2021 £m	2020 £m	Change %
<b>Summary of funds lent to customers and held as liquid assets</b>			
Unsecured loans and advances to customers	<b>3,344</b>	4,636	(28)
Secured loans and advances to customers	<b>1,255</b>	1,875	(33)
Cash, balances with central banks and other demand deposits	<b>968</b>	500	94
Financial investments	<b>587</b>	853	(31)
Loans and advances to banks	<b>37</b>	40	(8)
	<b>6,191</b>	7,904	(22)
<b>Summary of funds raised</b>			
Customer deposits	<b>5,128</b>	6,312	(19)
Other deposits	<b>1,161</b>	1,680	(31)
Other borrowed funds	–	101	(100)
Subordinated debt	<b>179</b>	180	(1)
	<b>6,468</b>	8,273	(22)

Underlying interest income decreased to £241 million driven by lower customer balances. Mortgage balances reduced by £620 million and represent 27% of total lending as at 28 February 2021. The portfolio continues to run off as customers opt to change mortgage provider.

Interest payable decreased by 30% driven by 54 basis points reduction in average blended savings rates and a 12% reduction in average funding balances in line with decreased lending. With the Mortgage book rolling off, overall funding requirements are reducing, some of which has been exacerbated by the temporary fall off in new lending volumes as a result of lockdown restrictions.

Net interest margin decreased to 2.4%, driven by lower customer volumes generating lower returns partially offset by decline in interest payable.

#### Fee, commission, and other operating income

	2021 £m	2020 £m	Change %
<b>Fee, commission, and other operating income summary</b>			
Banking income	<b>41</b>	76	(46)
Insurance income	<b>26</b>	26	–
Other income	<b>1</b>	2	(50)
<b>Total fees and commissions receivable</b>	<b>68</b>	104	(35)
Total fees and commissions payable	<b>(9)</b>	(10)	(10)
Other operating income	<b>2</b>	40	(95)
<b>Net fees, commission, and other operating income</b>	<b>61</b>	134	(54)

Banking income decreased by 46% largely driven by a reduction in retail spend and foreign travel driving lower Credit Card fees and lower cash usage during lockdown adversely impacting ATM income.

Insurance income remained flat year-on-year despite lockdown restrictions reducing Travel Insurance new business volumes significantly as customers were unable to travel abroad. Car and Home insurance remained resilient with renewals up 11% and 8% respectively.

The 95% decline in other operating income was driven by the closure of our Travel Money business following lockdown restrictions across the United Kingdom.

#### Operating expenses and investment

	2021 £m	2020 £m	Change %
<b>Operating expenses summary</b>			
Underlying staff costs	<b>58</b>	75	(23)
Other underlying operating costs	<b>119</b>	137	(13)
Depreciation of property, plant and equipment	<b>3</b>	8	(63)
Amortisation of intangible assets	<b>20</b>	23	(13)
<b>Underlying operating expenses</b>	<b>200</b>	243	(18)
Non-underlying operating expenses	<b>126</b>	25	404
<b>Total operating expenses</b>	<b>326</b>	268	22

Underlying operating expenses of £200 million decreased by £43 million year-on-year as they benefited from lower volume related costs and the redeployment of Travel Money colleagues into the stores after Bureaux were closed (the associated costs being recharged to the retailer). This was further supported by:

- management action to reduce our colleague headcount as part of our Target Operating Model review;
- optimisation of our customer journey and operations;
- mitigation of fraud losses; and
- successful delivery of cost savings through contract negotiations.

Total depreciation and amortisation for the financial year reduced 63% following the impairment of fixed assets at the half year, providing a cost benefit in the second half of the year.

Non-underlying costs are largely associated with the impairment of fixed assets following the review carried out in the year of the Bank's capitalised assets (refer to note 19 for more details). Other non-underlying costs relate to ongoing migration of the Loans Back Book, which is expected to be completed in FY22, and restructuring costs as we continue to reshape our business to remain efficient and cost effective.

	2021 £m	2020 £m	Change %
<b>Summary of fixed assets</b>			
Intangible assets	<b>155</b>	234	(34)
Property, plant and equipment	<b>11</b>	38	(71)
	<b>166</b>	272	(39)

Intangible assets were £155 million and tangible assets were £11 million, a decrease of £79 million and £27 million respectively since prior year. This was mainly due to an impairment assessment of fixed assets following the impact of COVID-19 on the Bank's product suite, totalling £105 million.

Intangible additions in the year were £23 million as we improve our mobile app to remain digitally focused and enhance our banking platforms by adapting to new regulations and creating operational efficiencies. Tangible additions of £1 million related to improved functionality and security of our ATM estate.

#### Impairment losses on financial assets

	2021 £m	2020 £m	Change %
<b>Impairment losses summary</b>			
Impairment losses on financial assets	<b>58</b>	48	21
Bad debt asset ratio	<b>1.1%</b>	0.7%	0.4

Impairment losses have increased 21%, whilst the bad debt asset ratio increased from 0.4% to 1.1% mainly to account for the expected future unemployment increases due to COVID-19, partly offset by a lower underlying impairment charge driven by balance sheet contraction. Economic scenarios have been modelled using multiple forward-looking economic scenarios and associated weightings. Judgements are applied to adjust modelled outputs to reflect future economic losses where they are not fully captured or when a financial asset has experienced a significant increase in credit risk.

The pandemic has required our business to change and adapt quickly to economic circumstances which have been evolving throughout the financial year. We have offered customer support through payment holidays and increased our investment in Collections and Recoveries to help those who need it. Government action, particularly the furlough scheme, has been key to maintaining lower levels of modelled provisioning by reducing the impacts of lower GDP and higher unemployment.

Despite the threat that COVID-19 poses, the Bank is very well capitalised with an increase in CET1 ratio to 17.6%. Additionally, the Bank has substantial excess liquidity with the LCR increasing 186% to 306%. We therefore remain confident that the Bank will not require capital injections from Group, in line with our strategic objective.

We are well positioned for recovery with strong capital and liquidity which we can deploy to grow balances and revenues in a safe and controlled manner.

By order of the Board

#### Donald McNaughton

Company Secretary  
28 April 2021

# Directors' Report

The Directors have the pleasure in submitting their annual report and the financial statements of Sainsbury's Bank plc ('the Bank') for the year ended 28 February 2021.

## Board of Directors

The Board comprises two Executive Directors and six Non-Executive Directors. The position and remuneration of members who served during the year is described in the following table:

Name	Position	Remunerating entity	Appointment/resignation date
Lesley Jones	Chair (Independent Non-Executive)	Sainsbury's Bank plc	Appointed 29 January 2021
Roger Davis	Chair (Independent Non-Executive)	Sainsbury's Bank plc	Resigned 29 January 2021
Peter Clarke	Senior Independent Non-Executive	Sainsbury's Bank plc	
Michael Ross	Independent Non-Executive	Sainsbury's Bank plc	
Carole Butler	Independent Non-Executive	Sainsbury's Bank plc	
Guy Thomas	Independent Non-Executive	Sainsbury's Bank plc	
Clodagh Moriarty	Non-Executive	J Sainsbury plc	
James Brown	Chief Executive Officer	Sainsbury's Bank plc	
Michael Larkin	Chief Financial Officer	Sainsbury's Bank plc	

Unless otherwise stated above, all of the Directors in office at the date of this report served throughout the period, and up to the date of approval of these financial statements.

### Board selection criteria

We regard succession at Board and senior management level as a key priority. Recruitment into the Board combines an assessment of both technical, leadership capability and competency skills to ensure the optimum blend of individual and aggregate capability having regard to our long term strategic plan. Board recruitment is subject to the approval of the Nominations Committee, the Board and the relevant regulatory bodies (PRA/FCA).

### Board diversity

We are committed to promoting a diverse and inclusive workplace at all levels, reflective of the communities in which we do business. Our diversity and inclusion vision aligns with that of our parent J Sainsbury plc whose aim is to be 'the most inclusive retailer'. We will achieve this aspiration by recruiting, retaining and developing diverse and talented people and creating an inclusive environment where everyone can be the best they can be and where diverse views are welcomed. The Nominations Committee is responsible for ensuring there is an appropriate balance of skills and experience across the Board.

### Directors' indemnities

The Bank has provided an indemnity for the benefit of all of its current Directors which is a qualifying third-party indemnity provision for the purpose of the Companies Act 2006. This was in force throughout the financial year and at the date of signing of the financial statements. Directors' and Officers' insurance is provided through the J Sainsbury plc Group policy. Neither the indemnities nor the insurance provide cover in the event that the Director is proved to have acted fraudulently.

**Statement of corporate governance arrangements**

Refer to the governance section of the Strategic Report on page 14 for the Bank's governance arrangements.

**Employee engagement**

Refer to the S172(1) statement on page 11 of the Strategic Report for details on employee engagement.

**Business relationships**

Refer to the S172(1) statement on page 12 of the Strategic Report for details on business relationships.

**Colleagues**

Refer to the S172(1) statement on page 11 for the Bank's policies on colleagues and the employment of disabled persons.

**Charitable and other donations**

During the year the Bank made charitable donations in the UK of £40,250 (2020: £41,429). No political donations were made during the year (2020: £nil).

**Independent auditors**

Ernst & Young LLP have expressed their willingness to continue in office as auditors.

**Disclosure of information to auditors**

At the date of this report, each of the Directors in office has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Bank's auditors are aware of that information. As far as each Director is aware, there is no relevant audit information of which the Bank's auditors are unaware.

**Financial risk management**

Details of the use of financial instruments, together with risk management disclosures, can be found in note 35 and the Risk management section in the Strategic Report on pages 5 to 8.

**Future developments**

The development of the Bank is set out in the Strategic Report on pages 3 to 5.

**Post balance sheet events**

Details of events occurring after the reporting date are discussed in note 42 to the financial statements.

**Going concern**

The Directors have considered the appropriateness of the going concern basis of preparation of the financial statements taking into account the Bank's current and projected performance.

The risk management framework as described in the Strategic Report on page 5 is considered adequate in managing liquidity and other key risks in the current environment. The Bank continues to maintain its strong capital and liquidity position and has also been subject to review and challenge by the PRA as part of its remit as lead regulator of the Bank. Further information on the key financial risks of the business can be found in note 35.

The Directors are satisfied that the Bank has adequate resources to continue in business for the foreseeable future, being at least 12 months from the date of approval of the financial statements, taking into account a range of possible operational, economic and legal scenarios. Consequently, the going concern basis continues to be appropriate in preparing the financial statements.

**Dividends**

The loss after tax for the year attributable to the shareholders is £156 million (2020: £7 million profit). The Directors do not recommend payment of a dividend (2020: £nil).

By order of the Board and signed on its behalf by

**Donald McNaughton**

Company Secretary  
28 April 2021

## Statement of Directors' responsibilities

The Directors are responsible for preparing the Strategic Report, Directors' report and the financial statements in accordance with applicable law and regulations.

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 international accounting standards in conformity with the requirements of the Companies Act 2006. Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of Sainsbury's Bank plc ('the Company') and of the profit or loss of the Company for that period. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies in accordance with International Accounting Standard 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in international accounting standards in conformity with the requirements of the Companies Act 2006 is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial performance; and
- state that the Bank has complied with international accounting standards in conformity with the requirements of the Companies Act 2006, subject to any material departures and explained in the financial statements.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also 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 responsible for the maintenance and integrity of the Annual Report and Financial Statements and Pillar 3 disclosures included on the J Sainsbury plc website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

By order of the Board and signed on its behalf by

**Donald McNaughton**

Company Secretary

28 April 2021

# Independent Auditors' Report

## Independent auditors' report to the members of Sainsbury's Bank plc

### Opinion

We have audited the financial statements of Sainsbury's Bank plc ("the Bank") for the year ended 28 February 2021 which comprise the Income Statement, the Statement of Comprehensive Income, the Balance Sheet, the Statement of Changes in Equity, the Cash Flow Statement, and the related notes 1 to 42, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Accounting Standards in conformity with the requirements of the Companies Act 2006.

In our opinion, the financial statements:

- give a true and fair view of the company's affairs as at 28 February 2021 and of its loss for the year then ended;
- have been properly prepared in accordance with International Accounting Standards in conformity with the requirements of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### Basis for opinion

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Our evaluation of the directors' assessment of the Bank's ability to continue to adopt the going concern basis of accounting included:

- We performed a walkthrough to confirm our understanding of the Bank's financial statement close process, which included how Management undertakes their own going concern assessment. We engaged with Management early to ensure all key factors were considered in their assessment;
- We obtained an understanding of Management's rationale for use of the going concern basis of accounting through reviewing their going concern assessment conclusions, which stressed the underlying forecasts and assumptions, and performing inquiries of Management and those charged with governance;
- We evaluated Management's going concern assessment which included reviewing their evaluation of the Bank's resilience to financial and operational stress on capital and liquidity requirements. The Bank included a number of adverse scenarios in their forecasts in order to incorporate unexpected changes to their forecasted capital and liquidity levels and we have tested the clerical accuracy of these forecasts and assessed the assumptions applied within the forecasts;
- We evaluated Management's assessment by considering viability under different stress scenarios, including the impact of strategic plans and the economic impact of COVID-19;

- We have reviewed Management's reverse stress testing in order to identify what factors would lead to all of the Bank's capital and liquidity eroding during the going concern period and assessed those factors against the likelihood of occurrence;
- We considered the Bank's operational resilience and its response to the impact COVID-19 has had on its business operations, including the operations of its third-party providers; and
- We reviewed the Bank's going concern disclosures included in the annual report in order to assess that the disclosures were appropriate and in conformity with the reporting standards.

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 Bank's ability to continue as a going concern for a period of 12 months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Bank's ability to continue as a going concern.

### Overview of our audit approach

Key audit matters	<ul style="list-style-type: none"> <li>— Expected credit loss provisions</li> <li>— Revenue recognition – Effective interest rate method</li> <li>— Strategic changes planned or implemented by the Bank, particularly as it relates to the valuation of intangible assets</li> <li>— Reliance on the processes and controls of third-party service providers</li> </ul>
Materiality	— Overall materiality of £3.25 million which represents 1.5% of gross margin (net interest income and net fees and commissions income).

### An overview of the scope of our audit

#### Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Bank. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Bank and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed. All audit work was performed directly by the audit engagement team.

#### Key audit matters

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

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<p><i>Expected Credit Loss Provisions</i></p> <p><i>Impairment Provision (2021: £174 million, 2020: £183 million)</i></p> <p><i>Note 13 of the Financial Statements (page 45)</i></p> <p>Customer receivables comprise unsecured personal loans; credit cards; and mortgages. Credit provisions represent Management's best estimate of impairment and significant judgements and estimates are made in determining the timing and measurement of expected credit loss ('ECL').</p> <p>The key judgements and estimates in respect of the timing and measurement of ECL include:</p> <ul style="list-style-type: none"> <li>(a) Completeness and accuracy of data;</li> <li>(b) The accounting interpretations and modelling assumptions used to build the models that calculate ECL;</li> <li>(c) Input and assumptions used to estimate the impact of the multiple economic scenarios;</li> <li>(d) Allocation of assets to stage 1, 2 or 3 using criteria in accordance with the accounting standard;</li> <li>(e) Completeness and valuation of post model adjustments; and</li> <li>(f) Accuracy and adequacy of the financial statement disclosures.</li> </ul> <p>We consider the risk related to the ECL provisions to have increased from the prior year due to the continued economic uncertainty as a result of COVID-19.</p>	<p>We performed procedures to assess the design effectiveness of key controls across the processes relevant to the impairment provision calculation, involving specialists to assist us in performing our procedures where appropriate. This included consideration of model governance, data accuracy and completeness, multiple economic scenarios, and the allocation of assets into stages.</p> <p>We performed control testing over the key controls identified to ensure that the controls operated effectively throughout the period. This considered the key elements identified in the previous paragraph.</p> <p>We reviewed the minutes of the model and risk committees where inputs, assumptions, and adjustments to the ECL were discussed and approved.</p> <p>We verified the data used in the ECL calculation on a sample basis. In order to complete this testing, we independently reconciled a sample of data feeding the model from source systems.</p> <p>We considered the assumptions, inputs and formulas used across the entire population of ECL models. This included assessing the appropriateness of model design and the formulas used, considering alternative modelling techniques and recalculating the Probability of Default, Loss Given Default and Exposure at Default for a sample of the models.</p> <p>With the support of our internal modelling specialists, we performed testing over models implemented during the year to validate that they were functioning as intended.</p> <p>We tested the assumptions and inputs used in the ECL models with the support of our internal modelling and economic specialists. In particular, we challenged the correlation and impact of the macroeconomic factors to the ECL and independently recalculated critical components of the ECL. In addition, we assessed the base and alternative economic scenarios, including challenging probability weights and comparing to other scenarios from a variety of external sources, as well as EY internally developed forecasts.</p> <p>We assessed whether forecasted macroeconomic variables used within the models, such as GDP and unemployment, were appropriate by performing a benchmark analysis against the Bank's peers. We also considered the different weightings applied to the various economic scenarios in our analysis.</p> <p>We challenged the criteria used to allocate an asset to stage 1, 2 and 3 in accordance with IFRS 9 and reviewed assets in stages 1, 2, and 3 to verify that they were allocated to the appropriate stage. This review included consideration of the impact of emergency payment freezes (EPF) on the stage of an account. We have tested that the key data elements (KDEs) relevant to EPFs, namely the entry date and the exit date, have been correctly reflected in the system.</p> <p>We challenged model overlays for appropriateness using our knowledge and experience across the industry. We assessed the appropriateness of the scenarios and calculations used in determining the overlay to be applied in response to the economic uncertainty due to COVID-19.</p> <p>We assessed the adequacy and appropriateness of disclosures for compliance with the accounting standards.</p>	<p>We are satisfied that provisions for the impairment of loans and advances to customers were reasonable and recognised in accordance with the applicable reporting framework based on our procedures performed.</p> <p>We recalculated the staging and noted no material differences. We also performed sensitivity analysis on the staging criteria and noted that substantial changes would be needed to the criteria to result in a material difference.</p> <p>The economic uncertainty overlay was within our independently established reasonable range.</p> <p>Our testing of models and model assumptions identified some instances of over and under estimation. We aggregated these differences and were satisfied that the overall estimate recorded was reasonable.</p>

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<i>Revenue Recognition – Effective Interest Rate (EIR) Method</i>		
<p>EIR Asset (2021: £109 million, 2020: £109 million) Notes 2, 3, 4, and 13 of the Financial Statements (pages 37, 40, 41 and 45)</p> <p>Accounting standards require that interest income on personal loans, credit cards and mortgages is recognised at the effective interest rate (EIR). For products with introductory rates, such as credit cards, where the reversionary interest rate in future years is expected to be greater but receipt of such interest income depends on the customer remaining with the Bank, there is significant judgement involved in forecasting customer behaviour and estimating the future expected cash flows. As such, we have identified a fraud risk related to the timing of revenue recognition through the Management override of internal controls.</p> <p>The risks, as we see them, are that:</p> <p>(a) the data used in making the estimate is not complete and accurate;</p> <p>(b) the judgements made are not appropriate; and</p> <p>(c) the calculation methodology is not applied correctly.</p> <p>We consider the risk related to recognition of revenue using the effective interest rate method, including the associated fraud risk, to be consistent with the prior year.</p>	<p>We performed procedures to obtain an understanding of the key controls in place over the EIR process.</p> <p>We considered the completeness and accuracy of data inputs into the models by:</p> <p>(i) inspecting reconciliations from the general ledger to the source systems; and subsequently from the general ledger to the electronic data warehouse.</p> <p>(ii) verifying the data used in the EIR calculation on a sample basis. In order to complete this testing, we have independently reconciled a sample of data feeding the model from the source system.</p> <p>We tested the appropriateness of Management's assumptions by:</p> <p>(i) Reviewing Management's methodology paper to assess if the variables mentioned are in accordance with the applicable accounting standards.</p> <p>(ii) Comparing judgements to:</p> <ul style="list-style-type: none"> <li>— Observable recent customer behaviour, including the impacts of COVID-19;</li> <li>— Product pricing models; and</li> <li>— Consideration of future expected changes.</li> </ul> <p>(iii) Testing for indications of Management bias through:</p> <ul style="list-style-type: none"> <li>— Comparison of customer behaviour to observable market data;</li> <li>— Review of judgements made by Management for consistency with prior periods where appropriate;</li> <li>— Assessment of Management's sensitivity analysis to determine whether the EIR adjustments were within an appropriate range and reasonable in relation to the impact of COVID-19;</li> <li>— Performing a sensitivity analysis over the impact of alternative behavioural lives and challenging the current behavioural lives used; and</li> <li>— Challenging model true-ups for appropriateness using our knowledge and experience across the industry, including assessing the appropriateness of the data, scenarios and calculations used in the determining the true-up applied.</li> </ul> <p>We tested the application of the calculation methodology by:</p> <p>(i) Engaging our modelling experts to test that the variables/assumptions stated in Management's methodology paper are modelled in Management's workings;</p> <p>(ii) Engaging our modelling experts to review the macros that are used to input the raw data into the model files;</p> <p>(iii) Performing sample testing on the year-end calculation of EIR, including the underlying data integrity, the clerical accuracy of the calculation, and the application of relevant assumptions; and</p> <p>(iv) Performing sensitivity analysis on individual cohorts to validate the model moves in line with expectation.</p>	<p>We are satisfied that the assumptions used in determining the EIR asset balance are reasonable and in accordance with the applicable accounting framework.</p> <p>We obtained assurance over the completeness and accuracy of data used within the EIR models through performing reconciliations of the data to source systems and sample testing of data attributes.</p> <p>We obtained assurance that the EIR model assumptions, including behavioural life, were reasonable in the context of current market data and observable customer behaviours.</p> <p>We observed that the models were operating effectively in the calculation of EIR adjustments and that the results were accurately reflected in the general ledger.</p>

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<i>Strategic changes planned or implemented by the Bank, particularly as it relates to the valuation of intangible assets</i>		
<p>Intangible Asset – Net Book Value (2021: £155 million, 2020: £234 million)</p> <p>Note 19 of the Financial Statements (page 54)</p> <p>The Bank has embarked on a number of initiatives as a result of the strategic changes announced in September 2019.</p> <p>Additionally, the Bank has updated their forecasts as a result of the economic impact of COVID-19 and identified indicators of impairment in their intangible asset portfolio, performing an impairment assessment during the year to calculate the impairment charge recorded.</p> <p>These changes impact the valuation of existing intangible asset balances, as well as the capitalisation of future costs incurred.</p> <p>The risks, as we see them, are that:</p> <p>(a) The impact on the financial statements as a result of decisions in strategic direction are not recorded accurately or in a timely manner;</p> <p>(b) The judgements made are not appropriate, including those related to future forecasts; and</p> <p>(c) The calculation of impairment is not accurate or applied to the correct assets, impacting future run costs.</p> <p>We consider the risk related to the strategic changes planned or implemented by the Bank to have increased from the prior year due to the impact of COVID-19. This includes the increased risk related to the valuation of intangible assets due to the impairment calculated and recorded during the year.</p>	<p>We performed procedures to obtain an understanding of the key controls in place over the intangible asset process, including the related impairment assessment, and challenged the design and operating effectiveness of those key controls identified.</p> <p>We obtained Management's impairment assessment that was undertaken in the first half of the year as a result of indicators of impairment being identified at that time. We undertook an analysis of the updated corporate plan to identify key assumptions in the impairment calculation and whether these appropriately considered the impacts of COVID-19 and the related economic uncertainty. This included challenging the impacts of strategic changes on future forecasted periods.</p> <p>We assessed the methodology applied by Management in identifying cash-generating units (CGUs) and in calculating the impairment charge at the individual asset level.</p> <p>We evaluated Management's forecast at an individual asset level, as well as at a cash-generating unit (CGU) level and then undertook stress testing over the related key assumptions and then assessed the impact on the impairment calculation.</p> <p>We obtained the allocation of the total impairment charge at an individual asset level and assessed this for reasonableness.</p> <p>We assessed the useful economic lives assigned to a sample of intangibles assets to ensure that the assigned lives are appropriate based on the asset class and the impacts of any strategic changes.</p> <p>We obtained Management's year-end impairment assessment, compared the current year results to forecast, and assessed future period forecasts to identify indicators of impairment at year-end. We also reviewed historical performance against budget to conclude on the accuracy of the Bank's budgeting process.</p> <p>We reviewed the intangible asset register to confirm that no costs were capitalised for asset categories that were fully or partially impaired as a result of the interim impairment assessment performed.</p> <p>We reviewed significant contracts and agreements with material third parties of the Bank and assessed the need for any onerous contract provisions to be recorded as a result of the strategic changes.</p>	<p>We are satisfied that the impairment taken in the financial year is reasonable and has been appropriately recorded during the period.</p> <p>We are satisfied that the assumptions implicit in the valuation of intangible assets at year-end are reasonable and that strategic changes made during the year have been accurately reflected within the financial statements in accordance with the applicable reporting framework.</p>

Risk	Our response to the risk	Key observations communicated to the Audit Committee
<i>Reliance on the processes and controls of third-party service providers</i>		
<p>Many of the Bank's IT systems are hosted by third parties. The Bank receives reports, prepared by independent audit firms, on the effectiveness of the third parties' control environments. In some instances, deficiencies in the control environment were identified or assurance was unable to be provided by the third party over the design and operating effectiveness of their control environment.</p> <p>There is a risk that there is insufficient oversight of the third-party service providers and where control deficiencies at the third-party are identified, a report is not obtained, or assurance is unable to be obtained over the third-party control environment. These risks are:</p> <p>(a) not mitigated by compensating controls within the Bank's own control environment; and</p> <p>(b) not appropriately quantified by the Bank.</p> <p>We consider the risk related to the oversight of third-party service providers to have increased in the current year due to a change in the Bank's ability to rely on the design and operating effectiveness of controls in place at a key third-party service organisation.</p>	<p>We performed procedures to obtain an understanding of the processes which are outsourced to third parties and their impact on the financial statements.</p> <p>We made inquiries of Management to understand the process through which the Bank:</p> <p>(i) Monitors control effectiveness at third parties, including any impact on their processes and controls as a result of COVID-19; and</p> <p>(ii) Performs control activities over the completeness and accuracy of data received from third parties.</p> <p>We tested the design and operating effectiveness of Management's key controls in place over third-party service providers that directly impact financial reporting.</p> <p>For the third-party service provider control reports obtained by the Bank, we obtained and inspected the reports to understand the design and operating effectiveness of the key controls in place. Where control deficiencies were identified or assurance over the control environment was unable to be provided, we assessed the impact on our planned audit procedures and, where necessary, performed incremental procedures in order to obtain reasonable assurance over the impacted account balances.</p> <p>We reviewed the assessment performed by Management over the third-party service provider control reports, including:</p> <p>(i) The mapping of the key controls within the report to the processes in place at the Bank and identification of any complimentary end user controls in place at the Bank; and</p> <p>(ii) Management's evaluation of any ineffective controls within the control reports.</p> <p>Where reports were not obtained or reports that were obtained were unable to provide reliance over the third-party control environment, we obtained and reviewed Management's assessment of these observations and the mitigating controls in place at the Bank. We tested the compensating controls where appropriate. Where we were no longer able to rely on controls as a result of the deficiencies identified, we reassessed our planned audit procedures over impacted balances and performed incremental substantive testing procedures in order to obtain reasonable assurance over account balances.</p>	<p>We obtained reasonable assurance over the Bank's processes and controls over the completeness and accuracy of data received from third parties.</p> <p>Where deficiencies were identified at third-party service providers or reports were unable to be obtained, we obtained reasonable assurance over the completeness and accuracy of the impacted account balances through identifying and testing compensating controls in place at the Bank or performing incremental substantive testing procedures.</p>

In the prior year, our auditor's report included a key audit matter in relation to the impact of COVID-19.

In the current year, we have incorporated the impact of COVID-19 into our planned audit procedures for the above key audit matters and therefore have not included this as a separate matter in our report.

### Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

### Materiality

*The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.*

We determined materiality for the Bank to be £3.25 million (2020: £3.5 million), which is 1.5% (2020: 1%) of gross margin (net interest income and net fees and commissions income). The increase in percentage applied to determine our materiality, which is within the acceptable range proposed by our audit methodology, was based on consideration of various factors, including changes in the business environment and the viability of the business. We believe that gross margin provides us with an appropriate basis for materiality as the Bank is a profit-oriented entity but loss making in the current year.

### Performance materiality

*The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.*

On the basis of our risk assessments, together with our assessment of the company's overall control environment, our judgement was that performance materiality should be established at 50% (2020: 50%) of our planning materiality, namely £1.6 million (2020: £1.75 million). We have set performance materiality at this percentage based on various considerations, including the past history of misstatements, the effectiveness of the control environment and other factors affecting the entity and its financial reporting, which is consistent with our approach in the prior year.

### Reporting threshold

*An amount below which identified misstatements are considered as being clearly trivial.*

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of £0.16 million (2020: £0.175 million), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. This is consistent with the prior year.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

### Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

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

We have nothing to report in this regard.

### Opinions on other matters prescribed by the Companies Act 2006

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

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and directors' report have been prepared in accordance with applicable legal requirements.

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

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or directors' report.

We have nothing to report in respect of the following matters in relation to which the Companies Act 2006 requires us to report to you if, in our opinion:

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

### Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out on page 23, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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.

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

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

### Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

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

However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the Bank and Management.

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Bank and determined that the most significant are the regulations, licence conditions and supervisory requirements of the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA') and the Companies Act 2006.

- We understood how Sainsbury's Bank plc is complying with those frameworks by making inquiries of Management, internal audit, and those responsible for legal and compliance matters. We also performed a review of regulatory correspondence and reviewed minutes of the Board and Board Risk Committee meetings held. We gained an understanding of the Bank's approach to governance demonstrated by the Board's enterprise risk management framework ("ERMF") and internal control processes. We also reviewed the Bank's complaints process and Whistleblowing Policy.
- We assessed the susceptibility of the Bank's financial statements to material misstatement, including how fraud might occur by assessing the controls that the Bank has established to address risks of fraud identified by the Bank, or that otherwise seek to prevent, deter, or detect fraud. We also considered performance and incentive plan targets and their potential to influence Management to manage earnings.
- Based on this understanding we designed our audit procedures to identify non-compliance with such laws and regulations. Our procedures involved inquiries of legal counsel, executive management, internal audit, and performed procedures over the risk of management override of internal control. We also focused our audit procedures on areas identified as higher risk as referred to in the Key Audit Matters section of this report.
- The Bank operates in the financial services industry which is a highly regulated environment. As such the Senior Statutory Auditor considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at <https://www.frc.org.uk/auditorsresponsibilities>. This description forms part of our auditor's report.

#### Other matters we are required to address

- Following a recommendation from the Audit Committee, we were appointed by the Bank on 16 August 2017 to audit the financial statements for the year ending 28 February 2018 and subsequent financial periods.
- The period of total uninterrupted engagement including previous renewals and reappointments is four years, covering the years ending 28 February 2018 to 28 February 2021.
- The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Bank and we remain independent of the Bank in conducting the audit.
- The audit opinion is consistent with the additional report to the Audit Committee

#### Use of our report

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

#### Peter Wallace

Senior statutory auditor  
for and on behalf of Ernst & Young LLP

Statutory Auditor  
Edinburgh  
28 April 2021

#### Notes:

1. The maintenance and integrity of the **Sainsbury's Bank plc** website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

# Financial Statements

## Income statement

For the year ended 28 February 2021

	Note	2021 £m	2020 £m
Interest income	3	<b>241</b>	304
Interest expense	3	<b>(81)</b>	(115)
<b>Net interest income</b>		<b>160</b>	189
Fees and commissions income	4	<b>68</b>	104
Fees and commissions expense	4	<b>(9)</b>	(10)
<b>Net fees and commissions income</b>		<b>59</b>	94
Other operating income	5	<b>2</b>	40
<b>Total income</b>		<b>221</b>	323
Administrative expenses	6	<b>(198)</b>	(232)
Impairment of intangible and tangible assets			
Property, plant and equipment	20	<b>(23)</b>	(5)
Intangible assets	19	<b>(82)</b>	–
Depreciation and amortisation			
Property, plant and equipment	20	<b>(3)</b>	(8)
Intangible assets	19	<b>(20)</b>	(23)
<b>Operating expenses</b>		<b>(326)</b>	(268)
Impairment losses on financial assets	13, 34	<b>(58)</b>	(48)
Realised gains on financial instruments	7	<b>1</b>	1
Fair value (losses) on financial instruments	7	<b>–</b>	(3)
<b>(Loss)/profit before taxation</b>		<b>(162)</b>	5
Analysed as:			
Underlying profit before tax		<b>(36)</b>	33
Non-underlying items	8	<b>(126)</b>	(28)
		<b>(162)</b>	5
Taxation	12	<b>6</b>	2
<b>(Loss)/profit for the financial year attributable to the owners of the Bank</b>		<b>(156)</b>	7

The accompanying notes on pages 36 to 85 form part of these financial statements.

## Statement of comprehensive income

For the year ended 28 February 2021

	Note	2021 £m	2020 £m
<b>(Loss)/profit for the financial year</b>		<b>(156)</b>	7
<b>Other comprehensive income:</b>			
Items that may be reclassified subsequently to profit or loss:			
Financial assets fair value movements	31	<b>1</b>	2
Items that do not qualify for reclassification to profit or loss:			
Financial assets fair value movements	31	<b>1</b>	–
<b>Total other comprehensive income, net of tax</b>		<b>2</b>	2
<b>Total comprehensive (expense)/income</b>		<b>(154)</b>	9

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 36 to 85 form part of these financial statements.

**Balance sheet****As at 28 February 2021**

	Note	2021 £m	2020 £m
<b>Assets</b>			
Cash, balances with central banks and other demand deposits	15	<b>968</b>	500
Loans and advances to banks <sup>1</sup>	16	<b>37</b>	40
Derivative financial instruments	17	<b>2</b>	6
Investment securities	18	<b>587</b>	853
Loans and advances to customers	13	<b>4,599</b>	6,511
Investments in subsidiaries	21	<b>325</b>	325
Intangible assets	19	<b>155</b>	234
Property, plant and equipment	20	<b>11</b>	38
Other assets <sup>1</sup>	22	<b>754</b>	895
<b>Total assets</b>		<b>7,438</b>	9,402
<b>Liabilities</b>			
Customer accounts	23	<b>5,128</b>	6,312
Other deposits	24	<b>1,161</b>	1,680
Other borrowed funds	25	<b>–</b>	101
Subordinated liabilities	26	<b>179</b>	180
Derivative financial instruments	17	<b>29</b>	35
Other liabilities	27	<b>84</b>	86
Provisions for liabilities and charges	28	<b>8</b>	8
<b>Total liabilities</b>		<b>6,589</b>	8,402
<b>Equity</b>			
Called up share capital	29	<b>901</b>	901
Retained earnings	30	<b>(55)</b>	98
Other reserves	31	<b>3</b>	1
<b>Total equity</b>		<b>849</b>	1,000
<b>Total equity and liabilities</b>		<b>7,438</b>	9,402

<sup>1</sup> Loans and advances to banks were previously presented within other assets.

The financial statements on pages 31 to 85 were approved by the Board of Directors on 28 April 2021 and signed on its behalf by:

**Michael Larkin**

Director and Chief Financial Officer

The accompanying notes on pages 36 to 85 form part of these financial statements.

Sainsbury's Bank plc – Company number 3279730

**Statement of changes in equity****For the year ended 28 February 2021**

	Note	Called up share capital £m	Retained earnings £m	Other reserves £m	Total equity £m
<b>As at 1 March 2020</b>		<b>901</b>	<b>98</b>	<b>1</b>	<b>1,000</b>
Loss for the financial year		–	(156)	–	(156)
Other comprehensive income:					
Financial assets fair value movements (FVOCI)	31	–	–	2	2
<b>Total comprehensive income</b>		<b>–</b>	<b>(156)</b>	<b>2</b>	<b>(154)</b>
Transactions with owners:					
Share-based payment (net of tax)		–	3	–	3
<b>At 28 February 2021</b>		<b>901</b>	<b>(55)</b>	<b>3</b>	<b>849</b>

	Note	Called up share capital £m	Retained earnings £m	Other reserves £m	Total equity £m
<b>As at 1 March 2019</b>		866	87	(1)	952
Profit for the financial year		–	7	–	7
Other comprehensive income:					
Financial assets fair value movements (FVOCI)	31	–	–	2	2
<b>Total comprehensive income</b>		<b>–</b>	<b>7</b>	<b>2</b>	<b>9</b>
Transactions with owners:					
Shares issued in the year	29	35	–	–	35
Share-based payment (net of tax)		–	4	–	4
<b>At 29 February 2020</b>		<b>901</b>	<b>98</b>	<b>1</b>	<b>1,000</b>

All amounts are attributable to the owners of the Bank.

The accompanying notes on pages 36 to 85 form part of these financial statements.

**Cash flow statement****For the year ended 28 February 2021**

	Note	2021 £m	2020 £m
(Loss)/profit before taxation		<b>(162)</b>	5
Non-cash and other items included in profit before taxation		<b>202</b>	99
Change in operating assets and liabilities <sup>1</sup>		<b>450</b>	(185)
Income taxes repayments		<b>2</b>	2
Cash flows generated from/(used in) operating activities	14	<b>492</b>	(79)
Purchase of equipment		<b>(1)</b>	(3)
Purchase of intangibles		<b>(23)</b>	(34)
Cash flows used in investing activities		<b>(24)</b>	(37)
Proceeds from issue of share capital	29	–	35
Interest paid on subordinated liabilities		<b>(11)</b>	(11)
Lease payments		<b>(1)</b>	–
Cash flows (used in)/generated from financing activities		<b>(12)</b>	24
<b>Change in cash and cash equivalents</b>		<b>456</b>	(92)
Opening cash and cash equivalents		<b>572</b>	664
<b>Closing cash and cash equivalents</b>		<b>1,028</b>	572

For the purposes of the cash flow statements, cash and cash equivalents comprise the following:

	2021 £m	2020 £m
Cash, balances with central banks and other demand deposits	<b>968</b>	500
Less: mandatory reserve deposit held at central banks	<b>(17)</b>	(18)
	<b>951</b>	482
Loans and advances to banks <sup>1</sup>	<b>27</b>	40
Investment securities	<b>50</b>	50
	<b>1,028</b>	572

1 Cash and cash equivalents presented in the financial statements as at 29 February 2020 has been amended to reflect £40 million of loans to banks due in less than three months that was previously presented within other assets.

The accompanying notes on pages 36 to 85 form part of these financial statements.

# Notes to the financial statements

## 1. Basis of preparation

The Bank's financial statements have been prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006.

These financial statements have been prepared under the historical cost convention as modified for the revaluation of financial assets and liabilities (including derivative instruments) held at fair value through profit and loss and fair value through other comprehensive income. The principal accounting policies have been applied consistently throughout the year.

The preparation of financial statements in conformity with the requirements of the Companies Act 2006 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 2.

The financial statements have been prepared on a going concern basis. This is discussed in the Directors' report, under the heading 'Going concern'.

The Directors have considered the appropriateness of the going concern basis of preparation of the financial statements taking into account the Bank's current and projected performance.

The risk management framework as described in the Strategic Report on page 5 is considered adequate in managing liquidity and other key risks in the current environment. The Bank continues to maintain its strong capital and liquidity position and has also been subject to review and challenge by the PRA as part of its remit as lead regulator of the Bank. Further information on the key financial risks of the business can be found in note 35.

The Directors are satisfied that the Bank has adequate resources to continue in business for the foreseeable future taking into account a range of possible operational, economic and legal scenarios. Consequently, the going concern basis continues to be appropriate in preparing the financial statements.

The Bank is a wholly-owned subsidiary of J Sainsbury plc and is included in the consolidated financial statements of J Sainsbury plc which are publicly available. Consequently, the Bank has taken advantage of the exemption from preparing consolidated financial statements under the terms of section 400 of the Companies Act 2006 and IFRS 10 4(a).

### Foreign currencies

The financial statements are presented in Sterling which is the Bank's functional and presentation currency. Foreign currency transactions are translated into Sterling at the exchange rate prevailing at the date of the transaction. Monetary assets and liabilities are translated at balance sheet date exchange rates. Exchange differences arising are recognised in the income statement.

### Classification and measurement of financial instruments

The Bank classifies all of its financial assets based on the business model for managing the assets and the assets' contractual terms, measured at either:

- Amortised cost,
- Fair value through other comprehensive income (FVOCI), or
- Fair value through profit and loss (FVPL)

To determine their classification and measurement category, IFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' contractual cash flow characteristics.

The business model assessment reflects how the Bank manages the risks relating to the underlying financial assets, including whether the Bank's principal objective is to collect the contractual cash flows arising from the instruments (amortised cost), to sell the financial instruments (FVPL) or a combination thereof (FVOCI).

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as how performance is reported to the entity's key management personnel, the way that risks are managed, how managers of the business are compensated and the expected frequency, value and timing of sales, which are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking 'worst case' or 'stress case' scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

As a second step of its classification process, where the business model involves the collection of contractual cash flows, the Bank assesses the contractual cash flow characteristics of financial assets to identify whether they can be considered solely payments of principal and interest (the SPPI test).

### Amortised cost

Financial assets that are principally held for the collection of contractual cash flows which pass the SPPI test are classified as amortised cost. Initial recognition is at fair value and subsequent measurement is at amortised cost, using the effective interest rate method, less provision for impairment as described in the impairment section below.

### Fair value through other comprehensive income

Financial assets that are held for both the purpose of collecting contractual cash flows and to sell are classified as FVOCI. Initial recognition and subsequent measurement is at fair value, with movements in fair value being recognised through OCI. Interest income is measured using the effective interest rate method and impairment gains and losses are recognised in the income statement.

### Fair value through profit and loss

Financial assets that do not meet amortised cost or FVOCI criteria are classified as FVPL.

### Equity instruments

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of Equity under IAS 32 *Financial instruments: Presentation* and are not held for trading. Such classification is determined on an instrument-by-instrument basis. Gains and losses on these equity instruments are never recycled to profit. Dividends are recognised in profit or loss as other operating income.

Where this election is not applied equity instruments are measured at FVPL.

### Financial liabilities

Other than derivative financial liabilities, all of the Bank's financial liabilities are recognised at amortised cost. Derivatives are classified as FVPL.

## 1. Basis of Preparation continued

### Standards and interpretations effective for the Company in these financial statements:

The Bank has adopted Interest Rate Benchmark Reform – Phase 1 (Amendments to IFRS 9, IAS 39 and IFRS 7) from 1 March 2020 and elected to early adopt Interest Rate Benchmark Reform – Phase 2 (Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) (the Phase 2 amendments).

#### Interest rate benchmark reform

The Bank applied the Phase 1 amendments which became effective from 1 January 2020 and the Phase 2 amendments retrospectively. However, in accordance with exceptions provided in the Phase 2 amendments, the Bank has elected not to restate the prior period to reflect the application of these amendments, including not providing additional disclosures for 2020. There is no impact on opening equity balances as a result of retrospective application.

The Phase 1 amendments provided reliefs that may otherwise have resulted in the Bank no longer being able to apply hedge accounting for certain hedge relationships as a result of uncertainties arising from the LIBOR benchmark reform. As a result of the reliefs the Bank was able to continue existing hedge accounting whilst implementing its LIBOR to SONIA transition project.

The Phase 2 amendments provide practical relief from certain requirements in the standards. These reliefs relate to modifications of financial instruments, lease contracts or hedging relationships when a benchmark interest rate in a contract is replaced with a new alternative benchmark rate. When the basis for determining the contractual cash flows of a financial instrument is changed as a direct consequence of interest rate benchmark reform and is made on an economically equivalent basis, the Phase 2 amendments provide a practical expedient to update the effective interest rate of a financial instrument before applying the existing requirements in the standards. The amendments also provide an exception to use a revised discount rate that reflects the change in interest rate when remeasuring a lease liability because of a lease modification that is required by interest rate benchmark reform.

Finally, the Phase 2 amendments provide a series of reliefs from certain hedge accounting requirements when a change required by interest rate benchmark reform occurs to a hedged item and/or hedging instrument and consequently the hedge relationship can be continued without any interruption. The details of the accounting policies are disclosed in note 17.

#### Other standards and amendments

The Bank has considered the amendment to IFRS 3 for a definition of a business that was effective from 1 March 2020 and the amendment was deemed to not have a significant impact on the Bank's financial statements.

### Standards and interpretations effective for the Company in future periods:

None of the following standards issued by the IASB but not yet effective, are expected to have a material impact on the Bank's financial statements in future periods:

— IFRS 17 'Insurance Contracts'

## 2. Critical accounting estimates and judgements

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, most critically in respect of impairment losses on loans and advances, effective yield and the valuation of investment securities.

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

### Impairment of loans and advances

Impairment loss models involve the estimation of future cash flows of financial assets, based on observable data at the balance sheet date and historical loss experience for assets with similar credit risk characteristics. This will typically take into account the level of arrears, security, past loss experience and default levels. These calculations are undertaken on a portfolio basis using various statistical modelling techniques. Impairment models are continually reviewed to ensure data and assumptions are appropriate with the most material assumption being around expected loss rates.

#### Significant increase in credit risk (SICR)

The Bank determines whether there has been a significant increase in credit risk by reference to quantitative thresholds, qualitative indicators and has also chosen to adopt the rebuttable backstop presumption that credit risk has significantly increased if contractual payments are more than 30 days past due.

Quantitative thresholds have been determined that when the PD of an instrument as at the reporting date has increased to greater than a specified multiple of the origination PD, a significant increase in credit risk is deemed to have occurred.

Qualitative tests are based around selective credit origination policy rules. In addition to variable risk appetite metrics, certain rules are permanently in place at account origination in order to decline accounts that may demonstrate factors outside of risk appetite that are not yet reflected in PD measures. At the reporting date, if an account satisfies any of these policy decline rules that it had not at the point of origination, it will be considered to have significantly increased in credit risk.

There is no probationary period applied in respect of accounts that cure from Stage 2 to Stage 1. Transfer criteria have been subject to extensive analysis to ensure that they appropriately reflect the flow of accounts from origination to default so as to maximise the number of accounts that flow through the stages and minimise accounts that jump from Stage 1 to Stage 3, or that fail to enter Stage 3 from Stage 2.

The Bank has applied the low credit risk exemption in respect of its high quality treasury portfolio held for liquidity purposes. This exemption permits low credit risk loans (i.e. those considered investment grade) to remain in Stage 1 without an assessment of significant increase in credit risk.

#### Definition of default

The Bank's definition of default is used in determining those accounts classified as Stage 3 (i.e. credit impaired). The Bank has chosen not to rebut the backstop presumption prescribed by IFRS 9 that where an account is 90 days or more past its due date then default has occurred.

The Bank has also defined a number of unlikelihood to pay criteria that result in an account being deemed to have defaulted. These include:

- Where operational collections activities have been exhausted on accounts that are less than 90 days past due and the account is subject to recoveries processes
- If any forbearance has been granted on the account
- Where the customer is subject to insolvency proceedings
- Where the customer is deceased

Where an account no longer meets any of the default criteria, such as by bringing payments back up to date, the Bank will continue to consider the account as being in default for a probation period of 24 months from the date when it last met the definition of default.

#### COVID-19 impact on IFRS 9 staging

There has been no material change in the approach to assessing significant increases in credit risk as a result of COVID-19. However, due to the impact of COVID-19 on the economic environment and subsequent impact on customers, the portion of unsecured loans in Stage 2 increased from 8.6% in 2020 to 13.2% in 2021. There was no material movement in secured loans.

## 2. Critical accounting estimates and judgements continued

The increase in Stage 2 assets was triggered by updated macroeconomic forecasts, reflecting a more negative outlook and increasing the volume of customer accounts exhibiting significant increases in credit risk. The granting of payment holidays to customers does not automatically trigger a SICR and these customers were not treated as past due or forborne. However, a customer that has been granted a payment holiday may still migrate to Stage 2 where triggers for SICR are met.

### Write-off

Loans and advances to customers are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the Bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to write-off. Subsequent recoveries of amounts previously written off result in impairment gains recorded in the income statement.

### Expected lifetime

For the purposes of considering the lifetime probability of default, the expected lifetime of a financial asset is the contractual term where this is fixed within the contract, or in the case of revolving products such as credit cards a behavioural life is determined by reference to historic trends.

### Modified financial assets

When the contractual cash flows of a financial asset have been renegotiated or modified and the financial asset was not derecognised, its gross carrying amount is recalculated as the present value of the modified contractual cash flows, discounted at the original effective interest rate with a gain or loss recognised in the income statement.

### Management overlays

In the context of IFRS 9 management overlays are short-term increases or decreases to the ECL at either a customer or portfolio level to account for items that have not been fully reflected in the existing models.

Internal governance is in place to regularly monitor management overlays and to reduce the reliance on management overlays through model recalibration or redevelopment, as appropriate.

Management overlays applied in estimating the reported ECL at 28 February 2021 are set out in the following table. The table includes adjustments in relation to data and model limitations. It shows the adjustments applicable to the scenario-weighted ECL numbers.

	As at 28 February 2021 £m	As at 29 February 2020 £m
Economic adjustment	<b>13</b>	5
PD adjustment	<b>10</b>	–
LGD adjustment	<b>7</b>	–
Operational overlays	<b>(1)</b>	2
<b>Total</b>	<b>29</b>	7

The proportion of management overlay is 17% of the total ECL provision as at 28 February 2021 (2020: 4%).

The Economic, LGD and PD adjustments have been included where provision models do not respond appropriately to the impacts of COVID-19.

The Economic adjustment is applied where the IFRS 9 models do not respond as expected to the magnitude of the forecast economic shock related to COVID-19. Offline models have been developed with an adjusted economic response to produce a more reasonable ECL that appropriately reacts to severe negative economic forecast. The Economic adjustment was initially increased to £23 million (2020: £5 million), but subsequently £10 million of this overlay requirement was embedded within live production models as they were adjusted to reflect the revised economic forecast.

The further PD adjustment is held to account for the uncertainty around both the economic assumptions regarding COVID-19 and the subsequent recovery and the impact that this will have on the Bank's ECL.

The LGD adjustment is applied to the ECL to account for the expectation that LGD will deteriorate due to the nature of COVID-19. Existing LGD models do not adequately respond to significant changes in economic variables.

The majority of the Operational overlays relate to model limitations that have been manually corrected whilst a permanent fix is being developed.

### Macroeconomic scenarios

IFRS 9 requires that the measurement of ECL should reflect an unbiased and probability weighted amount that is determined by evaluating a range of forward-looking economic assumptions. The Bank has engaged an external supplier to provide economic forecasts which are subject to review, challenge and approval through the Bank's governance processes.

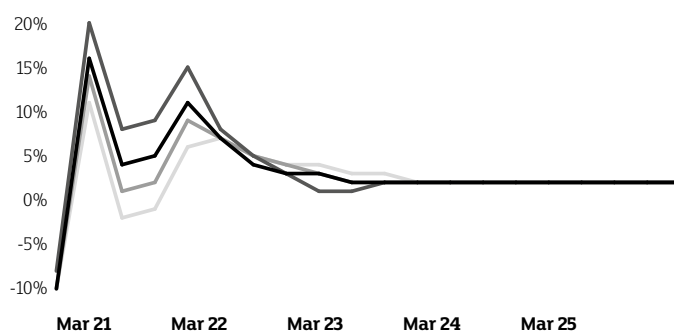
For the year ended 28 February 2021, the Bank commissioned economic scenarios to take account for the potential ramifications for COVID-19 which include a range of assumptions relating to exit from social restrictions, vaccine roll out and furlough and also includes an additional severe downside economic scenario.

The ECL models utilise four scenarios (2020: three scenarios) including a 'base case' scenario considered to be the most likely outcome together with an upside, downside and severe downside scenario. The base case has been assigned a probability weighting of 40% with the upside, downside and severe downside scenarios weighted 30%, 25%, 5% respectively (2020: base scenario 40%, upside and downside scenario 30% each).

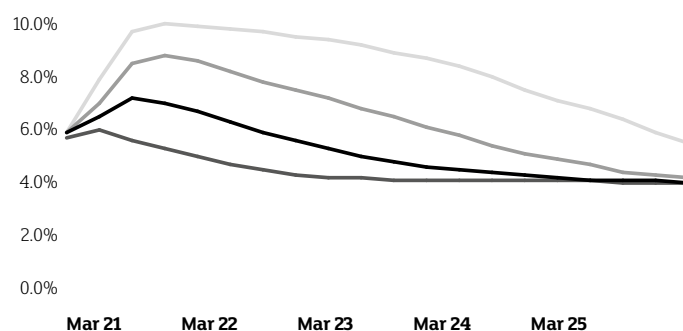
## 2. Critical accounting estimates and judgements continued

The graphs below plot the data for unemployment, GDP, consumer price growth and mortgage debt as a percentage of household income for each of the four scenarios used in our IFRS 9 models:

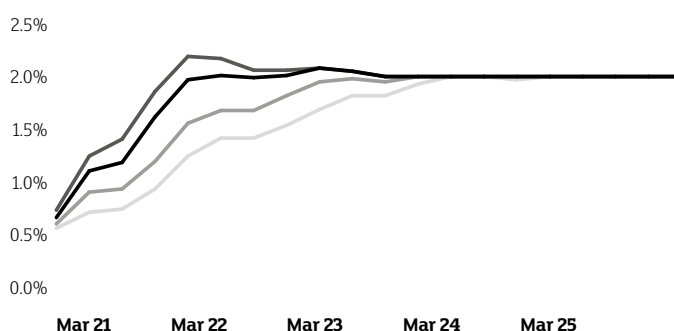
### Gross domestic product



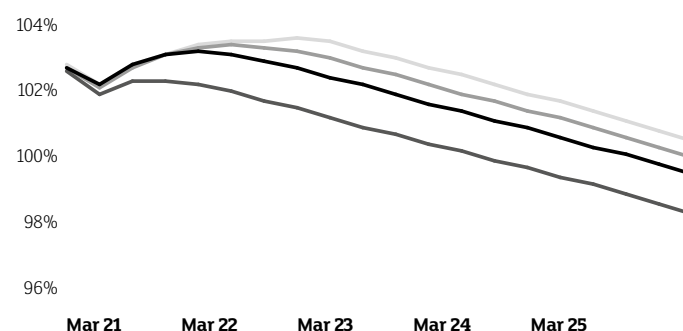
### UK unemployment rate



### Consumer price index



### Mortgage debt as % of household income



● Severe downside ● Downside ● Upside ● Base

The most material economic variables to the calculation of ECL are unemployment and GDP.

Our base case scenario envisages a peak unemployment of 7.2% in Q3 2021 before reverting to the long-term average in 2024 and an initial recovery in GDP with growth of 16% year-on-year at the end of Q2 2021 coinciding with the lifting of lockdown restrictions.

The key macroeconomic assumptions included in the ECL calculation have also been summarised in the table below (shown as five-year averages from the reporting date):

	As at 28 February 2021			
	Base %	Upside %	Downside %	Severe downside %
Unemployment rate	5.2	4.5	6.4	8.2
Consumer price growth	1.8	1.9	1.7	1.6
GDP	3.1	4.0	2.7	2.3
Mortgage debt as a percentage of household income	101.6	100.6	102.0	102.4
Real household disposable income	1.9	2.2	1.7	1.4
Probability weighting	40	30	25	5
Sensitivity analysis				
Increase/(decrease) on ECL provision under 100% probability weighting	£(0.5)m	£(9.8)m	£9.0m	£22.2m
Unsecured	£(0.5)m	£(9.7)m	£8.9m	£22.1m
Secured	–	£(0.1)m	£0.1m	£0.1m

The sensitivity disclosed above is based on the modelled ECL and the economic adjustment overlay and does not include the further PD, LGD and operational overlays.

## 2. Critical accounting estimates and judgements continued

	As at 29 February 2020		
	Base %	Upside %	Downside %
Unemployment rate	3.9	3.9	6.1
Consumer price growth	2.0	1.4	2.4
GDP	1.6	2.1	1.1
Mortgage debt as a percentage of household income	99.3	96.5	103.4
Real household disposable income	1.5	2.2	0.2
Probability weighting	30	40	30

Further explanation of the inputs, assumptions and estimation techniques used at the reporting date in measuring ECLs are set out at note 13.

### Capitalisation and carrying value of intangible assets

Capitalisation of intangible assets involves an assessment as to the appropriateness of costs that meet the qualifying criteria of IAS 38.

Intangible assets are assessed to ensure they continue to meet the criteria of IAS 38, and for indicators of impairment, at each balance sheet date or more frequently where required by changes in circumstances.

Where impairments are indicated, the carrying values of fixed assets are written down by the amount of the impairment and the charge is recognised in profit or loss in the period in which it occurs. A previously recognised impairment charge on an intangible asset may be reversed in full or in part where a change in circumstances leads to a change in the estimates used to determine its recoverable amount. The carrying value of the asset will only be increased to the carrying value at which it would have been held had the impairment not been recognised.

Impairments recognised in the period are disclosed in notes 19 and 20.

### Effective interest rate

In calculating the effective interest rate of a financial instrument the Bank takes into account all amounts that are integral to the yield of a financial instrument as well as incremental transaction costs. In the case of loans and advances to customers significant judgement is applied in estimating the effect of various factors, including future customer transactional and repayment behaviours, on future cash flows.

Estimates are based on historical experience from similar product types. Management considers that the most material judgement is the estimated life of Credit Card balances which is a maximum of 60 months (2020: 60 months).

To the extent that behavioural life differs by +/- 12 months, the value of loans and advances to customers on the balance sheet would be £7 million (2020: £10 million) higher or £8 million (2020: £11 million) lower respectively.

## 3. Net interest income

**Accounting policy** Interest income and expense in the income statement is determined using the effective interest rate method. This calculation takes into account all amounts that are integral to the yield as well as incremental transaction costs. The effective interest rate is the rate that discounts the expected future cash flows over the expected life of the financial instrument to the net carrying amount of the financial asset or liability at initial recognition.

The effective interest rate of a financial asset is calculated on initial recognition and is applied to the gross carrying amount of the asset. For financial assets that have subsequently become credit-impaired, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset net of any provision for expected credit losses. If the asset is no longer credit impaired, then the calculation of interest income reverts to the gross basis.

Interest income calculated using the effective interest method presented in the income statement includes interest on financial assets and financial liabilities measured at amortised cost, at fair value through other comprehensive income and the effective portion of hedge accounting instruments. Interest expense presented in the statement of profit or loss includes financial liabilities measured at amortised cost and the effective portion of hedge accounting instruments.

Interest income and expense on other financial assets and financial liabilities at FVPL are presented in fair value (losses) on financial instruments (see note 7).

Interest expense on lease liabilities are included within in the below categories as appropriate (see note 33).

### 3. Net interest income continued

	2021 £m	2020 £m
Interest income calculated using the effective interest rate method:		
Interest income on financial assets measured at amortised cost	<b>236</b>	294
Interest income on financial assets measured at FVOCI	<b>4</b>	9
Other interest income	<b>1</b>	1
Interest receivable	<b>241</b>	304
Interest expense on customer accounts, deposits and borrowings	<b>(45)</b>	(96)
Interest expense on subordinated liabilities	<b>(11)</b>	(11)
Interest expense on derivative liabilities	<b>(25)</b>	(8)
Interest payable	<b>(81)</b>	(115)
Net interest income	<b>160</b>	189

### 4. Net fees and commissions income

Accounting policy	Fees and commissions income
	Fees and commissions that are not integral to the effective interest rate calculation primarily relate to Credit Card and ATM interchange fees, and Insurance introduction commission receivable from insurance partners. These fees are recognised in line with the satisfaction of performance obligations. This can either be at a point in time or over time.
	<b>Banking income</b> The Bank earns income on Credit Card and ATM interchange fees, and from transaction-based fees which are charged to the customer's account. The revenue relating to transactions is recognised at the point in time when the transaction takes place.
	<b>Insurance income</b> The Bank earns commission income from the sale of insurance policies underwritten by a third party. This commission income is recognised as policies are sold, in line with the satisfaction of performance obligations to the customers.
	<b>Contract balances</b> Contract assets relate to the incremental costs of obtaining a contract with a customer. These costs are capitalised and deferred over the period to which performance obligations are satisfied and revenue is earned. Judgement is applied by management when determining what costs qualify to be capitalised, in particular whether these costs are incremental and whether they are expected to be recoverable.

#### Disaggregation of fees and commissions income

In the following table, fees and commissions income from contracts with customers in scope of IFRS 15 is disaggregated by major type of service.

	2021 £m	2020 £m
Banking income	<b>41</b>	76
Insurance income	<b>26</b>	26
Other income	<b>1</b>	2
Total fees and commissions income	<b>68</b>	104
Fees payable	<b>(9)</b>	(10)
Total fees and commissions payable	<b>(9)</b>	(10)
Net fees and commissions income	<b>59</b>	94

#### Contract balances

Capitalised costs incurred to obtain contracts in the year were £4 million (2020: £5 million) and the unamortised balance as at the reporting date, included within other assets in note 22 was £6 million (2020: £6 million). These costs relate to incremental costs of acquiring insurance contracts with customers.

The amount of amortisation recognised in the year relating to capitalised costs to obtain contracts with customers was £4 million (2020: £3 million).

## 5. Other operating income

**Accounting policy** Margin from the sale of Travel Money, representing the difference between the purchase price and the selling price, is recognised on the effective date of the customer transaction.

	2021 £m	2020 £m
Travel Money income	2	40
Other operating income	2	40

Travel Money income has reduced in the year due to the closure of Travel Money Bureaux due to COVID-19 travel restrictions.

## 6. Administrative expenses

	2021 £m	2020 £m
Staff costs:		
Wages and salaries	48	64
Social security costs	6	6
Pension costs	3	4
Share-based payments	3	4
	<b>60</b>	78
Other operating costs	<b>138</b>	154
	<b>198</b>	232

Staff costs and other operating costs include £21 million (2020: £25 million) of non-underlying items as described in note 8.

See note 9 for further details on employee arrangements.

## 7. Gains/(losses) on financial assets and liabilities

	2021 £m	2020 £m
Realised gains on derecognition	1	1
Fair value (losses) on hedge ineffectiveness of derivatives in hedge relationship	–	(3)

Further detail on the Bank's hedging policies is provided in note 17.

Finance fair value movements relate to net fair value movements on derivative financial instruments not designated in a hedging relationship and any hedge ineffectiveness that is expected to amortise over the remaining life of the hedged items.

## 8. Non-underlying items

Certain items recognised in the Bank's profit before taxation are of an unusual and infrequent nature and do not relate to the Bank's underlying performance. The Directors believe that the 'underlying profit before tax' measure presented provides a clear and consistent presentation of the underlying performance of the Bank. Underlying profit is not defined by IFRS and therefore may not be directly comparable with the 'adjusted' profit measures of other companies.

	2021 £m	2020 £m
Impairment of intangible and tangible assets	<b>(105)</b>	–
New bank programme transition costs	<b>(15)</b>	(16)
Strategic initiatives	<b>(6)</b>	(8)
Recharges from Group companies	–	(1)
Total non-underlying items – Costs	<b>(126)</b>	(25)
Finance fair value movements	–	(3)
Total non-underlying items – Gains/losses on financial instruments	–	(3)
Total non-underlying items	<b>(126)</b>	(28)

## 8. Non-underlying items continued

During the year the Bank undertook an impairment review of its intangible and tangible assets due to the impact of the COVID-19 pandemic, which resulted in an impairment of £105 million due to the related impacts on customer behaviours. Details of the impairment review are disclosed in note 19.

New Bank Programme transition costs principally comprise contractor and service provider costs relating to the migration of data and other services to the Bank's new infrastructure and operating model.

Strategic initiatives represent one-off costs relating to projects – this includes severance costs and related consultancy.

## 9. Employees

The average monthly number of colleagues working on the Bank's operations during the year is set out below.

	2021 Number	2020 Number
Full time	987	1,059
Part time	1,071	1,265
	<b>2,058</b>	2,324
Full time equivalent	<b>1,568</b>	1,738

Colleague costs are disclosed in administrative expenses in note 6.

Average colleague headcount, including contractors, fell 13% over the 12 months to February 2021. Included in average colleague headcount were 740 Travel Money colleagues (2020: nil) who were seconded to the Sainsbury's retail business, with the related costs being recharged. Further details on recharges is provided in note 40.

Colleagues are eligible to join the defined contribution pension arrangements of J Sainsbury plc. These plans are also used where colleagues have been automatically enrolled into a pension. Contributions paid by the Bank are based on grade and the amount that the colleague chooses to pay or whether they have been automatically enrolled.

The pension cost recharge for the year (see note 40) represents contributions payable by the Bank and was entirely in relation to the defined contribution schemes.

## 10. Directors' emoluments

	2021 £m	2020 £m
Emoluments	2.0	3.1
Employer contribution to defined contribution pension schemes	–	–
Share-based payments	0.8	1.7
Compensation for loss of office	–	0.4
	<b>2.8</b>	5.2
Highest paid Director:		
Emoluments	0.8	0.6
Share-based payments	0.4	0.1
	<b>1.2</b>	0.7

The Directors' positions and remuneration status are set out in the Directors' report on page 34. The emoluments set out above include those Directors who held office during the year.

All Executive Directors were employed and remunerated by the Bank.

During the year two Directors (2020: five) received share awards under J Sainsbury plc share incentive schemes reflective of their qualifying services. No Directors (2020: four) exercised share options in the year including the highest paid Director. Further detail of the relevant incentive plans are outlined in note 39.

During the year two Directors (2020: five) accrued retirement benefits in respect of qualifying services under defined contribution schemes. No Directors (2020: one) were paid a sum following retirement in the year.

Payments were made to independent Non-Executive Directors who served during the year and are included in the above details. There was no recharge to the Bank in respect of emoluments for Non-Executive Directors who were employed by J Sainsbury plc as their emoluments are deemed to be wholly attributable to services to the parent company. Accordingly, the above details include no emoluments in respect of these Non-Executive Directors (also see Directors' report on page 21).

## 11. Profit/(loss) before taxation

	2021 £m	2020 £m
Profit/(loss) before taxation is stated including the following items of income and (expense):		
Loss on disposal of intangible assets	–	(0.4)
Loss on disposal of tangible assets	<b>(1.6)</b>	–
Impairment loss	<b>(105.5)</b>	(5.2)
Auditors' remuneration:		
Statutory audit of the Bank	<b>(0.8)</b>	(0.9)

Details of the impairment loss are disclosed in note 19.

Audit-related assurance services were also performed by the Statutory Auditors during the year in respect of a limited assurance of interim balances. Fees for this work totalled £0.02 million (2020: £nil).

## 12. Taxation

**Accounting policy** Taxation on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Taxation is determined using tax rates (and laws) enacted or substantively enacted at the balance sheet date. Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax assets and liabilities are offset against each other when there is a legally enforceable right to set-off current taxation assets against current taxation liabilities and it is the intention to settle these on a net basis.

	2021 £m	2020 £m
UK corporation tax on profit for the year	–	–
Adjustments in respect of prior years	–	(3)
Current tax	–	(3)
Deferred tax charge		
Origination and reversal of temporary differences	<b>(9)</b>	–
Adjustments in respect of prior years	<b>3</b>	1
Deferred tax	<b>(6)</b>	1
Total tax (credit)	<b>(6)</b>	(2)

Differences between profit before tax multiplied by the UK corporation tax rate for the year of 19% and the income tax expense recognised in the income statement are explained below:

	2021 £m	2020 £m
(Loss)/profit before taxation	<b>(162)</b>	5
Tax on ordinary activities at 19% (2020: 19%)	<b>(31)</b>	1
Effects:		
Losses surrendered/(claimed) as group relief for nil consideration	<b>22</b>	(1)
Adjustment in respect of prior years	<b>3</b>	(2)
Total income tax (credit) recognised in the income statement	<b>(6)</b>	(2)

In the current period, the substantively enacted UK corporation tax rate applicable to the Company from 1 April 2020 was increased from 17% to 19%. The closing deferred tax assets and liabilities have been calculated at 19% and accordingly a rate change adjustment has arisen as the opening deferred tax balance had been calculated taking into account the previously enacted rate of 17%.

Since the balance sheet date, it was announced in the UK Government's Budget on 3 March 2021 that the main UK corporation tax rate will increase to 25% from 1 April 2023. This change has not yet been substantively enacted. As a result, existing temporary differences on which deferred tax has been provided may unwind in periods subject to the 19%/25% rate. The impact of the post balance sheet date change in tax rate is not expected to be material.

## 13. Loans and advances to customers

**Accounting policy** Loans and advances are initially recognised at fair value and subsequently held at amortised cost, using the effective interest method, less provision for impairment and recognised on the balance sheet when cash is advanced.

The accounting policies for classification and measurement under IFRS are detailed in note 1.

### ECL impairment model

IFRS 9 uses a three stage forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECL for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is calculated by reference to the estimated probability of default (PD), exposure at default (EAD) and loss given default (LGD).

The probability of default represents the likelihood of a borrower defaulting either within 12 months from the balance sheet date or within the expected lifetime of the instrument.

Exposure at default represents the expected amount due from the borrower at the point of default by reference to exposure at the balance sheet date adjusted for expected future changes including repayments and utilisation of undrawn facilities.

Loss given default represents the expected percentage loss at the point of default relative to the EAD. The estimate takes into account utilisation of any expected collections and recoveries strategies, debt sale arrangements and collateral.

The three stage model to determine impairment allowance is summarised as follows:

- **Stage 1** – Impairment allowance on financial assets that have not significantly increased in credit risk since origination, nor are credit impaired, is calculated using the probability that a borrower will default within 12 months from the balance sheet date. Interest income is recognised on the gross carrying value of the financial asset.
- **Stage 2** – Where a financial asset exhibits a significant increase in credit risk (SICR) but is not yet considered to be credit impaired, the probability of default considered in the impairment allowance is based upon the lifetime probability of the borrower defaulting. Interest income continues to be recognised on the gross carrying value of the financial asset.
- **Stage 3** – Assets considered to be credit impaired. One or more events has occurred that has resulted in a detrimental impact on the estimated future cash flows of the asset. Stage 3 assets will continue to recognise lifetime expected impairment losses (with a 100% probability of default) and interest income will be recognised on the net carrying amount (i.e. gross amount less impairment allowance).

In determining ECL allowances, expected future recoveries are discounted to the reporting date at the original effective interest rate of the relevant instrument.

A number of inputs and variables used in the ECL calculation are not defined within IFRS 9 and involve complex modelling and application of judgement as discussed in the remainder of this section.

### Undrawn commitments

Undrawn loan and credit card commitments are commitments under which the Bank is required to provide a loan with pre-specified terms to the customer. Under IFRS 9 these contracts are in scope of the ECL requirements.

The Bank is required to estimate the extent to which undrawn commitments and facilities will be utilised by borrowers.

The nominal contractual value of these commitments, where the lending agreed to be provided is on market terms, are not recorded in the statement of financial position. The ECLs in relation to undrawn commitments are disclosed in note 34. The impairment allowance in respect of these instruments is included within provisions for liabilities and charges as there is no related asset on balance sheet against which to offset the related impairment allowance.

### 13. Loans and advances to customers continued

	2021 £m	2020 £m
Gross advances	<b>4,750</b>	6,667
Impairment	<b>(174)</b>	(183)
Adjustment in relation to fair value hedging	<b>23</b>	27
Loans and advances to customers	<b>4,599</b>	6,511
Gross advances being:		
Repayable on demand	<b>1,518</b>	2,037
Other loans and advances repayable:		
In 3 months or less	<b>294</b>	361
Between 3 months and 1 year	<b>588</b>	760
Between 1 and 5 years	<b>1,304</b>	1,909
After 5 years	<b>1,046</b>	1,600
	<b>4,750</b>	6,667

The Bank's gross lending exposure before deduction of impairment provisions is analysed below:

	2021 £m	2020 £m
Individuals:		
Secured lending	<b>1,247</b>	1,862
Unsecured lending	<b>3,503</b>	4,805
Gross loans and advances to customers	<b>4,750</b>	6,667

The Bank has securitised and pledged personal loans and mortgage assets with the Bank of England as part of the Bank of England's Term Funding Scheme (TFS) and Indexed Long Term Repo Facility (ILTR). As at 28 February 2021 £623 million (2020: £1,586 million) of personal loans assets and £955 million (2020: £nil) of mortgage assets were pledged to the Bank of England facilitating funding of £950 million (2020: £950 million) from the TFS and £150 million (2020: £75 million) from the ILTR.

On 11 November 2020, the Bank securitised and sold £725 million of personal loans to a special purpose vehicle (SPV) as part of a new personal loans securitisation. The SPV issued a £500 million Senior class A note and £225 million Junior class Z note to the bank. As at 28 February 2021, the Bank had pledged £621 million of personal loans to the SPV. Further details are disclosed in note 40, related party transactions.

As at 28 February 2021, the Bank had pledged £11 million of the A note as part of a repurchase agreement generating £10 million of borrowings.

### 13. Loans and advances to customers continued

#### Unsecured allowance for impairment losses measured under IFRS 9

Reconciliation of impairment loss allowance and gross carrying amount of unsecured Loans and advances measured at amortised cost

	Non-credit-impaired				Credit-impaired		Total	
	Stage 1		Stage 2		Stage 3		Gross carrying amount £m	Loss allowance £m
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m		
As at 1 March 2020	<b>4,225</b>	<b>(23)</b>	<b>412</b>	<b>(29)</b>	<b>168</b>	<b>(131)</b>	<b>4,805</b>	<b>(183)</b>
Transfers of financial assets:								
To Stage 1	<b>72</b>	–	<b>(72)</b>	–	–	–	–	–
To Stage 2	<b>(191)</b>	<b>12</b>	<b>192</b>	<b>(12)</b>	<b>(1)</b>	–	–	–
To Stage 3	<b>(28)</b>	<b>20</b>	<b>(25)</b>	<b>16</b>	<b>53</b>	<b>(36)</b>	–	–
Net transfer between stages		<b>32</b>		<b>4</b>		<b>(36)</b>		–
Increases due to originations <sup>1</sup>	<b>417</b>	<b>(3)</b>	<b>19</b>	<b>(2)</b>	<b>2</b>	<b>(1)</b>	<b>438</b>	<b>(6)</b>
Decreases due to repayments	<b>(1,586)</b>	<b>2</b>	<b>(58)</b>	<b>2</b>	<b>(17)</b>	<b>11</b>	<b>(1,661)</b>	<b>15</b>
Write-offs	<b>(6)</b>	–	<b>(5)</b>	<b>1</b>	<b>(68)</b>	<b>51</b>	<b>(79)</b>	<b>52</b>
Changes in credit risk <sup>2</sup>		<b>(33)</b>		<b>(14)</b>		<b>(2)</b>		<b>(49)</b>
As at 28 February 2021	<b>2,903</b>	<b>(25)</b>	<b>463</b>	<b>(38)</b>	<b>137</b>	<b>(108)</b>	<b>3,503</b>	<b>(171)</b>

1 This also reflects assets which were originated in Stage 1 and subsequently moved to Stage 2 or Stage 3 during the year.

2 Changes in credit risk includes changes to the allowance for credit impairment losses arising from stage transfers and other changes to risk parameters (such as management overlays).

	Non-credit-impaired				Credit-impaired		Total	
	Stage 1		Stage 3		Stage 3		Gross carrying amount £m	Loss allowance £m
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m		
As at 1 March 2019	4,354	(25)	417	(28)	161	(127)	4,932	(180)
Transfers of financial assets:								
To Stage 1	61	–	(59)	–	(2)	–	–	–
To Stage 2	(173)	11	176	(11)	(3)	–	–	–
To Stage 3	(29)	19	(28)	17	57	(36)	–	–
Net transfer between stages		30		6		(36)		–
Increases due to originations <sup>1</sup>	932	(6)	33	(4)	7	(4)	972	(14)
Decreases due to repayments	(916)	3	(123)	2	(6)	4	(1,045)	9
Write-offs	(4)	–	(4)	1	(46)	46	(54)	47
Changes in credit risk <sup>2</sup>		(25)		(6)		(14)		(45)
As at 29 February 2020	4,225	(23)	412	(29)	168	(131)	4,805	(183)

1 This also reflects assets which were originated in Stage 1 and subsequently moved to Stage 2 or Stage 3 during the year.

2 Changes in credit risk includes changes to the allowance for credit impairment losses arising from stage transfers and other changes to risk parameters (such as management overlays).

### 13. Loans and advances to customers continued

#### Secured allowance for impairment losses measured under IFRS 9

Reconciliation of impairment loss allowance and gross carrying amount of secured Loans and advances measured at amortised cost

	Non-credit-impaired				Credit-impaired		Total	
	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m
As at 1 March 2020	<b>1,778</b>	<b>(0)</b>	<b>76</b>	<b>(0)</b>	<b>8</b>	<b>(0)</b>	<b>1,862</b>	<b>(0)</b>
Transfers of financial assets:								
To Stage 1	<b>26</b>	–	<b>(25)</b>	–	<b>(1)</b>	–	–	–
To Stage 2	<b>(16)</b>	–	<b>16</b>	–	–	–	–	–
To Stage 3	<b>(5)</b>	–	<b>(1)</b>	–	<b>6</b>	–	–	–
Net transfer between stages	–	–	–	–	–	–	–	–
Increases due to originations <sup>1</sup>	<b>4</b>	–	<b>2</b>	–	–	–	<b>6</b>	–
Decreases due to repayments	<b>(598)</b>	–	<b>(21)</b>	–	<b>(2)</b>	–	<b>(621)</b>	–
Write-offs	–	–	–	–	–	–	–	–
Changes in credit risk <sup>2</sup>	–	–	–	–	–	<b>(3)</b>	–	<b>(3)</b>
As at 28 February 2021	<b>1,189</b>	<b>(0)</b>	<b>47</b>	<b>(0)</b>	<b>11</b>	<b>(3)</b>	<b>1,247</b>	<b>(3)</b>

1 This also reflects assets which were originated in Stage 1 and subsequently moved to Stage 2 or Stage 3 during the year.

2 Changes in credit risk includes changes to the allowance for credit impairment losses arising from stage transfers and other changes to risk parameters (such as management overlays).

	Non-credit-impaired				Credit-impaired		Total	
	Stage 1		Stage 2		Stage 3		Total	
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m
As at 1 March 2019	1,267	(0)	169	(0)	5	(0)	1,441	(0)
Transfers of financial assets:								
To Stage 1	116	–	(115)	–	(1)	–	–	–
To Stage 2	(18)	–	19	–	(1)	–	–	–
To Stage 3	(4)	–	(1)	–	5	–	–	–
Net transfer between stages	–	–	–	–	–	–	–	–
Increases due to originations <sup>1</sup>	669	–	30	–	–	–	699	–
Decreases due to repayments	(252)	–	(26)	–	–	–	(278)	–
Write-offs	–	–	–	–	–	–	–	–
Changes in credit risk <sup>2</sup>	–	–	–	–	–	–	–	–
As at 29 February 2020	1,778	(0)	76	(0)	8	(0)	1,862	(0)

1 This also reflects assets which were originated in Stage 1 and subsequently moved to Stage 2 or Stage 3 during the year.

2 Changes in credit risk includes changes to the allowance for credit impairment losses arising from stage transfers and other changes to risk parameters (such as management overlays).

## 14. Notes to the cash flow statement

**Accounting policy** For the purpose of the cash flow statement cash and cash equivalents comprises cash in hand, deposits at central banks (less mandatory deposits) and deposits with banks with an original maturity of three months or less, together with Treasury Bills and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

### Reconciliation of profit before taxation to cash flows used in operating activities

	2021 £m	2020 £m
(Loss)/profit before taxation	<b>(162)</b>	5
<b>Non-cash and other items included in profit before taxation</b>		
Impairment losses on loans and advances	<b>58</b>	48
Depreciation on property, plant and equipment	<b>3</b>	8
Amortisation of intangible assets	<b>20</b>	23
Share-based payment expense	<b>3</b>	4
Impairment, gains, (losses) and disposals	<b>107</b>	5
Interest paid on subordinated liabilities	<b>11</b>	11
	<b>202</b>	99

### Change in operating assets and liabilities

Net decrease/(increase) in loans and advances to customers	<b>1,854</b>	(361)
Net decrease in derivative assets	<b>4</b>	2
Net (increase) in loans and advances to other banks greater than 3 months	<b>(10)</b>	–
Net decrease/(increase) in investment securities greater than 3 months	<b>269</b>	(180)
Net (decrease)/increase in derivative liabilities	<b>(6)</b>	27
Net decrease/(increase) in other assets <sup>1</sup>	<b>145</b>	(161)
Net (decrease)/increase in customer accounts	<b>(1,184)</b>	362
Net (decrease)/increase in borrowed funds	<b>(621)</b>	134
Net (decrease) in other liabilities including provisions	<b>(1)</b>	(8)
	<b>450</b>	(185)

Cash generated from/(used in) operations	<b>490</b>	(81)
Income taxes received	<b>2</b>	2
Cash flows generated from/(used in) operating activities	<b>492</b>	(79)

1 £40 million of loans to banks due in less than three months that was previously presented within other assets in the financial statements as at 29 February 2020 have been reclassified to cash and cash equivalents.

### Operational cash flows from interest

Interest paid	<b>(109)</b>	(110)
Interest received	<b>249</b>	288
	<b>140</b>	178

### Reconciliation of liabilities arising from financing activities

	2021 £m	2020 £m
Subordinated liabilities:		
At 1 March	<b>180</b>	176
Issuance of loan notes	–	–
Non-cash movements	<b>(1)</b>	4
At 28/29 February	<b>179</b>	180

#### 14. Notes to the cash flow statement continued

	2021 £m	2020 £m
Lease liabilities:		
At 1 March	6	6
Lease payments	(1)	–
Lease modifications	1	–
Lease interest	(1)	–
At 28/29 February	5	6

#### Restricted cash balances

	2021 £m	2020 £m
Bank of England deposit	17	18
	<b>17</b>	18

A reserve deposit is held with the Bank of England in accordance with statutory requirements. This deposit is not available for use in day-to-day operations and has been excluded from the cash and cash equivalents balance in the cash flow statement.

#### 15. Cash, balances with central banks and other demand deposits

	2021 £m	2020 £m
Cash and balances with central banks	937	426
Other demand deposits	31	74
	<b>968</b>	500

The balances with central banks are repayable on demand, with the exception of the £17 million (2020: £18 million) reserve deposit pledged to Bank of England as part of its Cash Ratio Deposit scheme (see note 14). There were no significant credit losses expected on cash and other demand deposits.

#### 16. Loans and advances to other banks

**Accounting policy** Loans and advances to other banks, including reverse repurchase agreements, are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

	2021 £m	2020 £m
Reverse repurchase agreements	37	40
Other loans and advances to other banks:		
On demand	–	–
In 3 months or less	27	40
Between 3 months and 1 year	10	–
	<b>37</b>	40

Reverse repurchase agreements have been reclassified to loans and advances to other banks. In the financial statements for the year ended 29 February 2020 £40 million was classified within other assets.

## 17. Derivative financial instruments

**Accounting policy** All derivative financial instruments are initially recognised at fair value on the contract date and are re-measured to their fair value at each subsequent reporting date. Changes in fair value of all derivative instruments are recognised immediately in the income statement. Fair values are obtained from observable market data before the application of appropriate discounting factors.

Where the overall carrying value of a derivative is positive it is held and classified on the balance sheet as an asset. Alternatively, when the overall carrying value of a derivative is negative it is held and classified as a liability.

The Bank intends to use derivatives for economic purposes only, and not for trading. Where possible it will elect to designate the derivative into an effective hedge accounting relationship, where the gains and losses on derivatives are offset by effective hedged item adjustments within the income statement.

### Fair value hedging

The Bank designates certain derivatives as fair value hedges where the derivative financial instrument hedges the change in fair value of the particular risks inherent in recognised assets or liabilities (fair value hedges).

The Bank has adopted IFRS 9 hedge accounting requirements for its fair value hedges of investment securities and its one-for-one hedge on its Fixed Rate Debt issuance. These instruments are hedged via plain vanilla interest rate swaps, with the critical economic terms of both the hedging instrument and hedged item matching. The notional amount, fixed interest legs and maturity dates are economically matched. The main source of ineffectiveness within the micro hedge relationships relates to the floating leg valuation changes inherent within the hedging instrument that do not exist within the hedged item.

The Bank continues to adopt IAS 39 for its macro portfolio fair value hedges of fixed rate personal loans and residential mortgages, as it is permitted to do so under IFRS 9 and until the point that the new macro hedge accounting standard is finalised and adopted.

Portfolio fair value hedging allows the designation of the whole or part of a portfolio of assets or liabilities with similar risk exposures. The hedged item can be designated based on expected maturities to match the hedging derivative maturity. Hedge effectiveness is considered to have been met where the change in fair value of the hedged item offsets the change in fair value of hedging instruments, within the 80 to 125% ratio corridor. Ineffectiveness on portfolio hedges can arise as a result of several factors, including floating leg valuation changes inherent within the hedging instrument that do not exist within the hedged item, mismatch in cash flow maturities between the hedged item and hedging instrument and basis risk between cash flows discounted using different benchmark rates e.g. LIBOR v OIS.

To qualify for hedge accounting, the Bank documents, at the inception of the hedge, the hedging risk management strategy, the relationship between the hedging instrument and the hedged item or transaction and the nature of the risks being hedged. The Bank also documents the assessment of the effectiveness of the hedging relationship, to show that the hedge is expected to be (prospectively) and, subsequently, has been (retrospectively) effective.

Fair value hedging matches the change in fair value of designated hedged items against the corresponding change in value of the hedging derivative. The designated hedged item can be a recognised asset or liability, a firm commitment or an identified portion of an asset.

### Derivatives not in a hedge accounting relationship

The Bank's entire derivative portfolio is executed for economic purposes. Under IAS 39 rules, for macro portfolio hedging, some of the Bank's hedging derivatives do not qualify, or prove too onerous, to be designated into an effective hedged relationship. In those instances, the interest rate swaps are viewed as trading derivatives under IFRS 9 with any movements in fair value recognised in the income statement, without offset.

### Specific policies for hedges affected by IBOR reform

In the financial year to 28 February 2021, the Bank completed its London Interbank Offered Rate (LIBOR) novation. From August 2019, all balance sheet interest rate exposures were hedged with swaps referencing the Sterling Overnight Index Average (SONIA) index, a risk-free rate. As at 28 February 2021, the Bank had interest rate derivatives with a notional of £1,805 million referencing LIBOR. £888 million is linked to compressed and offsetting LIBOR swaps (collapsed at London Clearing House (LCH) as at the 8 and 9 March 2021) forming part of the Bank's LIBOR transition project. Compressed and offsetting LIBOR swaps were excluded from fair value hedge accounting relationships. The remaining £917 million is linked to LIBOR swaps with a maturity date in advance of 31 December 2021. Such swaps were excluded from the Bank's LIBOR novation project and were included in fair value hedge accounting relationships

No interest rate derivatives will reference LIBOR following 31 December 2021.

### The Phase 1 amendments

If a hedging relationship is directly affected by IBOR reform, then the Bank applies certain exceptions (referred to as 'the Phase 1 amendments') to the general hedge accounting policy. The Bank considers that a hedging relationship is directly affected by IBOR reform if it is subject to the following uncertainty arising from the reform:

- an interest rate benchmark subject to the reform is designated as the hedged risk, regardless of whether the rate is contractually specified; and/or
- the timing or amounts of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument are uncertain.

## 17. Derivative financial instruments continued

The Phase 1 amendments to the Bank's policies are as follows.

- a. For the purpose of evaluating whether the hedging relationship is expected to be highly effective (i.e. prospective effectiveness assessment), the Bank assumes that the benchmark interest rate is not altered as a result of IBOR reform.
- b. If the Bank concludes that the actual result of a hedging relationship is outside the range of 80–125% (i.e. retrospective assessment), then the Bank determines whether the hedging relationship continues to qualify for hedge accounting or whether it needs to be discontinued. This includes, for example, determining that the hedge is expected to be highly effective prospectively and that the effectiveness of the hedging relationship can be reliably measured.

When the uncertainty arising from IBOR reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item or hedging instrument, or when the hedging relationship is discontinued, the Bank will cease to apply the respective Phase 1 amendments.

### The Phase 2 amendments

The Bank has early adopted the Phase 2 amendments and retrospectively applied the amendments from 1 March 2020. When the basis for determining the contractual cash flows of the hedged item or hedging instrument changes as a result of IBOR reform and therefore there is no longer uncertainty arising about the cash flows of the hedged item or the hedging instrument, the Bank amends the hedge documentation of that hedging relationship to reflect the change(s) required by IBOR reform. For this purpose, the hedge designation is amended only to make one or more of the following changes:

- designating an alternative benchmark rate as the hedged risk;
- updating the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged;
- updating the description of the hedging instrument; or
- updating the description of how the entity will assess hedge effectiveness.

The Bank amends the description of the hedging instrument only if the following conditions are met:

- it makes a change required by IBOR reform by changing the basis for determining the contractual cash flows of the hedging instrument or using another approach that is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument; and
- the original hedging instrument is not derecognised.

The Bank amends the formal hedge documentation by the end of the reporting period during which a change required by IBOR reform is made to the hedged risk, hedged item or hedging instrument. These amendments in the formal hedge documentation do not constitute the discontinuation of the hedging relationship or the designation of a new hedging relationship.

If changes are made in addition to those changes required by IBOR reform described above, then the Bank first considers whether those additional changes result in the discontinuation of the hedge accounting relationship. If the additional changes do not result in the discontinuation of the hedge accounting relationship, then the Bank amends the formal hedge documentation for changes required by IBOR reform as mentioned above.

### Fair value hedges

The amounts relating to items designated as hedging instruments and hedge ineffectiveness were as follows:

	Notional amount £m	Carrying amount		Ineffectiveness recognised in income statement £m
		Assets £m	Liabilities £m	
Interest rate swaps – Hedge of loans and advances				
At 28 February 2021	<b>3,363</b>	–	<b>(29)</b>	–
At 29 February 2020	4,299	6	(35)	(3)

Derivatives not in fair value hedge accounting relationship are as follows:

	Notional amount £m	Assets £m	Liabilities £m
Interest rate swap			
At 28 February 2021	<b>897</b>	–	–
At 29 February 2020	9	–	–
Foreign currency swap			
At 28 February 2021	<b>62</b>	<b>2</b>	–
At 29 February 2020	97	–	–

The line item in the statement of financial position where the hedging instrument is included is 'Derivative financial instruments'. The line item in the income statement that includes hedge ineffectiveness is 'Fair value (losses)/gains on financial instruments'.

## 17. Derivative financial instruments continued

The maturity profile and average price/rate of the hedging instruments in fair value hedges of interest rates were as follows:

	Maturity				
	Less than 1 month	1-3 months	3 months – 1 year	1-5 years	More than 5 years
<b>As at February 2021</b>					
Fair value hedges					
Nominal amount (£'m)	–	<b>328</b>	<b>973</b>	<b>1,441</b>	<b>621</b>
Average fixed interest rate	–	<b>0.9%</b>	<b>0.7%</b>	<b>0.6%</b>	–
<b>As at February 2020</b>					
Fair value hedges					
Nominal amount (£'m)	–	270	1,402	2,618	9
Average fixed interest rate	–	0.9%	0.7%	0.6%	–

### Foreign currency derivative assets

Foreign currency exposure arises from currency holdings within the Bank's Travel Money business. The Bank also hedges a US-dollar denominated deposit placed with MasterCard.

The Bank entered into foreign exchange derivative contracts to hedge foreign currency exposure. Foreign exchange derivative instruments included FX spot, FX forwards and FX swaps. As at 28 February 2021, the Bank reported a FX derivative asset of £1.4 million and a FX derivative liability of £0 million.

### LIBOR transition to SONIA

The Bank has reformed all of its derivative instruments linked to LIBOR that are not due to expire prior to 31 December 2021. Therefore, the Financial Services business does not need to reform any further contracts or rely on appropriate fallback clauses.

## 18. Investment securities

**Accounting policy** These comprise debt securities and other fixed interest securities, including Treasury and other eligible bills, and are recognised on the date the contract is entered into. Investment securities are measured at amortised cost or FVOCI based on their contractual terms and the business model in which they are held.

### Impairment of investment securities

As with customer lending, impairment of investment securities is determined under IFRS 9 – again using a three stage forward-looking expected credit loss (ECL) approach. IFRS 9 requires the Bank to record an allowance for ECL for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts. The allowance is calculated by reference to the estimated probability of default (PD), exposure at default (EAD) and loss given default (LGD).

	2021 £m	2020 £m
Investment securities comprise the following:		
Equity investments	<b>1</b>	–
Gilts	–	51
Government backed investment securities	<b>67</b>	86
Covered bonds	<b>126</b>	238
Supranational investment securities	<b>271</b>	319
Asset backed securities	<b>72</b>	109
Commercial paper	<b>50</b>	50
	<b>587</b>	853
Of which:		
Equity investments	<b>1</b>	–
Maturing in three months or less	<b>50</b>	50
Maturing between three months and one year	<b>91</b>	84
Maturing between 1 and 5 years	<b>445</b>	719
	<b>587</b>	853

Investment securities include £nil (2020: £300 million) pledged as collateral under sale and repurchase agreements or derivative contracts. Investment securities include £205 million of collateral prepositioned with the Bank of England as at 28 February 2021. The fair value movement recognised in the statement of other comprehensive income during the year on investment securities was a profit of £2 million (2020: £2 million).

## 18. Investment securities continued

Reconciliation of impairment loss allowance and gross carrying amount of investment securities measured at FVOCI

	Stage 1		Total	
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m
As at 1 March 2020	853	–	853	–
Purchases	558	–	558	–
Disposals	(824)	–	(824)	–
Write-offs	–	–	–	–
As at 28 February 2021	587	–	587	–

	Stage 1		Total	
	Gross carrying amount £m	Loss allowance £m	Gross carrying amount £m	Loss allowance £m
As at 1 March 2019	767	–	767	–
Purchases	576	–	576	–
Disposals	(490)	–	(490)	–
Write-offs	–	–	–	–
As at 29 February 2020	853	–	853	–

Under IFRS 9, the Bank holds an impairment provision for investment securities of £0.2 million (2020: £0.4 million).

## 19. Intangible assets

### Accounting policy

#### Computer software

Computer software is carried at cost less accumulated amortisation and any provision for impairment. Externally acquired software and licences are capitalised and amortised on a straight-line basis over their useful economic lives. Costs relating to development of computer software for internal use are capitalised once the recognition criteria of IAS 38 'Intangible Assets' are met. Other development expenditures that do not meet these criteria are recognised as an expense as incurred. When the software is available for its intended use, these costs are amortised on a straight-line basis over their useful economic lives being:

- Core banking software – fifteen years
- Other software – three to ten years

Capitalised development expenditure and purchased software is stated at cost less accumulated amortisation and impairment losses. Such assets are assessed for impairment where there is an indication of impairment or, in the case of assets which are not yet available for use, at least annually. Where impairment exists, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss recognised in the income statement. The amortisation charge for the asset is then adjusted to reflect the asset's revised carrying amount.

Cost includes the purchase price after deducting discounts and rebates, and other directly attributable costs of preparing the asset for its intended use.

Subsequent expenditure is only capitalised when it increases the future economic benefits embodied in the specific asset to which it relates.

## 19. Intangible assets continued

	2021 £m	2020 £m
<b>Cost</b>		
At 1 March	287	254
Additions	23	33
As at 28 February	310	287
<b>Accumulated amortisation</b>		
At 1 March	(53)	(30)
Charge for the year	(20)	(23)
Impairment	(82)	–
As at 28 February	(155)	(53)
Net book value as at 28 February	155	234

### Impairment

#### Approach and identification of cash generating units (CGUs)

At each reporting date, the Bank reviews the carrying amounts of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset, being the higher of its fair value less costs to dispose and its value in use, is estimated in order to determine the extent of the impairment loss.

The CGU is deemed to be each respective product or product group that is capable of generating cash flows independent of other products. Non-product assets are reviewed separately as corporate assets for the products that they support.

Any impairment loss is recognised in the income statement in the year in which it occurs. Where an impairment loss subsequently reverses due to a change in the original estimate, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, or its original carrying value less notional accumulated depreciation if lower.

#### Identification of a triggering event

The COVID-19 pandemic has resulted in changes to customer shopping habits, patterns and sources of finance. Despite this, the Bank has proved resilient through the pandemic, with significant liquidity and capital buffers. However, the changes in customer behaviour have led to a reduction in the Bank's short-term profitability. This has been deemed an indicator of impairment and a full impairment review was therefore performed with an effective date of 1 June 2020. After recognising the initial impairment arising at that time, there were no further indicators of impairment during the remainder of the financial year.

#### Approach and assumptions

The recoverable amounts for CGUs were determined using value in use calculations which were based on the cash flows expected to be generated, derived from the latest budget and forecast data which was reviewed by the Board. Budget and forecast data reflect both past experience and future expectation of market conditions.

The key assumptions in the value in use calculation were as follows:

Assumption	Detail
Composition of CGU	Property, plant and equipment and intangible assets attributable to each product (or group of products capable of generating independent cash flows).
Cash flow years/assumptions	Derived from Board approved corporate forecasts for five years and then extrapolated over the remaining useful lives of the assets being tested for impairment.
Terminal value	No terminal value is applied within the assessment, as cash flows are limited to the period of the remaining useful lives of the assets being tested for impairment.
Discount rate	A post-tax discount rate representing the Bank's weighted average cost of capital (WACC), subsequently grossed up to a pre-tax rate of 12.8%. The post-tax WACC has been calculated using a combination of adjusted market analysis and the actual cost of debt on Tier 2 capital instruments.

Of the total impairment charge of £105 million, £82 million relates to intangible assets and £23 million relates to property, plant and equipment.

Of the above assumptions, the value-in-use calculations are most sensitive to changes in the discount rate and cash flows. The table below set out the key sensitivities performed on the value-in-use models. The sensitivity analysis performed considers the reasonably possible changes in these assumptions, which incorporates increased uncertainty caused by the COVID-19 pandemic.

## 19. Intangible assets continued

Sensitivity area	Increase/ (decrease) in impairment £m
<b>Discount rate</b>	
Increase of 1%	10
Decrease of 1%	(10)
<b>Cash flows</b>	
Increase of 5%	(18)
Decrease of 5%	18

## 20. Property, plant and equipment

### Accounting policy

#### Land and buildings

Land and buildings are stated at cost less accumulated depreciation and any recognised provision for impairment. Capital work in progress is held at cost less any recognised provision for impairment. Cost includes the original purchase price of the asset and the costs incurred attributable to bringing the asset to its working condition for intended use. This includes capitalised borrowing costs.

#### Fixtures and equipment

Fixtures and equipment, including tenant's improvements, are held at cost less accumulated depreciation and any recognised provision for impairment. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition and its intended use.

#### Right of use assets

Right of use assets obtained under a lease arrangement are included in the above categories as appropriate and depreciated as described below. Accounting policies in relation to the measurement of right of use assets are outlined in note 33.

#### Depreciation

Depreciation is calculated to write down the cost of the assets to their residual values, on a straight-line method, on the following bases:

- Freehold buildings and leasehold properties – fifty years, or the lease term if shorter
- Fixtures and equipment – three to fifteen years or, in the case of tenant's improvements, the lease term if shorter

Capital work in progress is not depreciated.

Gains and losses on disposal are determined by comparing proceeds with the asset's carrying amount and are recognised within operating profit. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

	Land and buildings £m	Fixtures and equipment £m	Total £m
<b>28 February 2021</b>			
<b>Cost</b>			
At 1 March 2020	9	68	77
Additions	–	1	1
Disposals/write off	–	(7)	(7)
As at 28 February 2021	9	62	71
<b>Accumulated depreciation</b>			
At 1 March 2020	4	35	39
Charge for the year	1	2	3
Disposals	–	(5)	(5)
Impairment loss <sup>1</sup>	1	22	23
As at 28 February 2021	6	54	60
Net book value as at 28 February 2021	3	8	11

<sup>1</sup> For further details, see note 19, intangible assets.

## 20. Property, plant and equipment continued

	Land and buildings £m	Fixtures and equipment £m	Total £m
29 February 2020			
Cost			
At 1 March 2019	9	75	84
Additions	–	3	3
Disposals/write off	–	(10)	(10)
As at 29 February 2020	9	68	77
<b>Accumulated depreciation</b>			
At 1 March 2019	3	33	36
Charge for the year	1	7	8
Disposals	–	(10)	(10)
Impairment loss		5	5
As at 29 February 2020	4	35	39
Net book value as at 29 February 2020	5	33	38

Land and buildings include right of use assets of £3 million (2020: £3 million) related to head office premises. See note 33 for further details.

## 21. Subsidiary undertakings

**Accounting policy** Subsidiaries are entities, including special purpose vehicles (SPVs), over which the Bank has the power to govern the financial and operating policies. The results of subsidiaries are included in the income statement of the ultimate parent J Sainsbury plc.

Investments in subsidiaries are carried at cost less any impairment loss in the financial statements of the Bank.

	2021 £m	2020 £m
As at 28/29 February	<b>325</b>	325

	Country of registration or incorporation	Ownership Interest	Registered address
Home Retail Group Card Services Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW
Home Retail Group Insurance Services Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW
ARG Personal Loans Limited	England	100%	489-499 Avebury Boulevard, Milton Keynes, United Kingdom, MK9 2NW

The securitisation programme linked to Lochside Asset Purchaser No.1 plc was fully redeemed on 27 May 2020. Therefore, the Bank no longer has the rights to the benefit of this entity and the holding entity Lochside Asset Purchaser No.1 Holdings Limited and these entities are no longer deemed to be subsidiaries of the Bank from that date.

	Country of registration or incorporation	Date ceased being a subsidiary	Registered address
Lochside Asset Purchaser No.1 Holdings Limited	England	27 May 2020	35 Great St. Helen's, London, EC3A 6AP
Lochside Asset Purchaser No.1 plc	England	27 May 2020	35 Great St. Helen's, London, EC3A 6AP

On 11 November 2020, the Bank entered into a new personal loans securitisation programme. This resulted in the set up of a new subsidiary undertaking: Drury Lane Funding 2020-1 plc. Although the Bank has no direct or indirect ownership interest in the equity of the company, the company was established for the purpose of providing a source of funding to the Bank by way of contractual agreement and the Bank has the rights to substantially all the benefits from its activities. The company is therefore effectively controlled by the Bank.

	Country of registration or incorporation	Date started being a subsidiary	Registered address
Drury Lane Funding 2020-1 plc	England	11 November 2020	5 Churchill Place, 10th Floor, London, E14 5HU

## 22. Other assets

**Accounting policy** Other assets, including amounts receivable from Group companies, are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method.

	2021 £m	2020 £m
Amounts receivable from Group companies (see note 40)	484	558
Funds in course of settlement	125	174
Prepayments and accrued income	36	54
Insurance instalment debtor	26	25
Current tax asset	4	6
Deferred tax asset	7	2
Cash collateral paid	72	76
	<b>754</b>	895

Other assets have no fixed maturities but are expected to be realised within 12 months, with the exception of £18 million (2020: £24 million) included in prepayments and accrued income. This represents the present value of a rebate receivable in respect of the build of certain computer software which will be received over a period of time as the related software is utilised, which is expected to be greater than 12 months. See note 35 for further details on the residual contractual maturity of other assets.

The deferred tax asset is in respect of temporary differences which will reverse and result in a higher tax charge in future years, as follows:

	2021 £m	2020 £m
At 1 March	2	3
Movement in deferred tax asset credited to income statement	9	–
Movement in deferred tax asset charged to other comprehensive income	(1)	–
Adjustments in respect of prior years	(3)	(1)
At 28 February	7	2
Tax effect of timing differences due to:		
Other temporary differences	11	12
Accelerated capital allowances	(4)	(10)
	<b>7</b>	2

## 23. Customer accounts

**Accounting policy** Financial liabilities comprise customer accounts, deposits from banks, subordinated liabilities and other wholesale deposits. All financial liabilities are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. A financial liability is derecognised from the balance sheet when the Bank has discharged its obligations, the contract is cancelled or it expires.

Customer accounts comprise Sterling interest bearing deposits.

	2021 £m	2020 £m
Repayable:		
On demand	4,530	5,492
Within 3 months	113	170
Between 3 months and 1 year	281	397
Between 1 and 5 years	204	253
	<b>5,128</b>	6,312

## 24. Other deposits

**Accounting policy** All financial liabilities are initially recognised at fair value and subsequently measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issue of funds, and costs that are an integral part of the EIR. A financial liability is derecognised from the balance sheet when the Bank has discharged its obligations, the contract is cancelled or it expires.

Other deposits comprise Sterling wholesale deposits.

	2021 £m	2020 £m
Repayable:		
Within 3 months	243	448
Between 3 months and 1 year	918	281
Between 1 and 5 years	–	951
	<b>1,161</b>	1,680

## 25. Other borrowed funds

**Accounting policy** Other borrowed funds comprise deemed loans to SPVs arising where assets transferred to the SPVs have not met the derecognition criteria, and subordinated loan capital. These are initially recognised at fair value and subsequently held at amortised cost and the interest payable is recognised in the income statement through interest payable.

	2021 £m	2020 £m
<b>'Failed sale' liability on securitisation</b>		
Repayable in less than 1 year	–	101
Other borrowed funds	–	101

### Securitisation

The Bank's Lochside Asset Purchaser personal loans securitisation programme was fully redeemed on 27 May 2020 including the Senior class A note (£101 million as at 29 February 2020).

On 11 November 2020, the Bank securitised and sold £725 million of personal loans to a new SPV (Drury Lane Funding 2020-1 plc) as part of a new personal loans securitisation. The SPV issued a £500 million Senior class A note and £225 million Junior class Z note to the Bank.

As at 28 February 2021, the Bank held a £500 million Senior class A note and a £121 million class Z. There were no external investors in the loan notes issued by the SPV and as a result the Bank does not recognise a liability for the failed sale and separate asset for the notes held to avoid double counting of the rights and obligations pertaining to the personal loans subject to the securitisation.

For further details, see related parties note 40.

## 26. Subordinated liabilities

**Accounting policy** Subordinated liabilities are initially recognised at fair value and subsequently held at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issue of funds, and costs that are an integral part of the EIR. The interest payable is recognised in the income statement through interest payable.

	2021 £m	2020 £m
Fixed rate subordinated Tier 2 notes due November 2027	175	175
Accrued interest	2	2
Fair value hedge accounting adjustments	2	3
	<b>179</b>	180

The Bank has £175 million of fixed rate reset callable subordinated Tier 2 notes in issuance (29 Feb 2020: £175 million). The notes pay interest on the principal amount at a rate of 6% per annum, payable in equal instalments semi-annually in arrears, until 23 November 2022 at which time the interest rate will reset. The Bank has a call option to redeem these notes on 23 November 2022.

## 27. Other liabilities

**Accounting policy** Other liabilities are initially recognised at fair value and subsequently measured at amortised cost using the effective interest rate method. Specific policies in relation to the measurement of lease liabilities are outlined in note 33.

All other liabilities are expected to be settled within three months with the exception of lease liabilities.

	2021 £m	2020 £m
Customer funds in course of settlement	20	13
Accruals and deferred income	59	67
Lease liabilities	5	6
	<b>84</b>	86

## 28. Provisions for liabilities and charges

**Accounting policy** The Bank recognises a provision if there is a present obligation as a consequence of either a legal or a constructive obligation resulting from a past event. To recognise this it should be probable that an outflow of economic resources, that can be reliably measured, will be required to settle the obligation. Provisions are measured as the discounted expected future cash flows taking account of the risks and uncertainties associated with the specific liability where appropriate.

	2021 £m	2020 £m
Provision on loan commitments issued	6	8
Customer remediation	2	—
	<b>8</b>	8

### Provision on loan commitments issued

The movement on the provision for loss allowance on loan commitments is set out in note 34. It primarily relates to expected credit losses on credit card commitments.

### Customer remediation

	2021 £m	2020 £m
At 1 March	—	—
Charged to the income statement <sup>1</sup>	7	—
Utilised in the year	(5)	—
At 28/29 February	2	—

<sup>1</sup> The costs in relation to the customer remediation provision were reimbursed by a third party in accordance with contractual indemnity provisions of the related service agreement. The costs were presented net of the reimbursement resulting in £nil charge in the income statement.

## 29. Called up share capital

**Accounting policy** Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

	2021 £m	2020 £m
900,750,000 Authorised, allotted, called up and fully paid ordinary shares (£1):		
At 1 March	901	866
Ordinary shares issued during the financial year	—	35
At 28/29 February	<b>901</b>	901

During the year the Bank issued £nil (2020: 35 million) ordinary shares of £1 each at par to J Sainsbury plc. Details of post balance sheet events in relation to share capital are described in note 42.

### 30. Retained earnings

	2021 £m	2020 £m
At 1 March	98	87
(Loss)/profit for the financial year	(156)	7
Share-based payment (net of tax)	3	4
At 28/29 February	(55)	98

### 31. Other reserves

Other reserves comprise the unhedged fair value movements for investment securities. The reserve will unwind in line with the maturity profile of the underlying investment securities.

	Other reserves £m
At 1 March 2020	1
Net unrealised gains	3
Realised gains reclassified to the income statement on disposal	(1)
At 28 February 2021	3
At 1 March 2019	(1)
Net unrealised gains	3
Realised gains reclassified to the income statement on disposal	(1)
At 29 February 2020	1

These balances include deferred tax of £1 million in the reserve (2020: £nil).

### 32. Analysis of financial assets and liabilities by measurement basis

<b>Accounting policy</b>	<p><b>Designation of financial instruments</b> The Bank classifies all of its financial assets based on the business model for managing the assets and the assets' contractual terms, measured at either amortised cost, FVOCI or FVPL.</p> <p>The Bank classifies and measures its derivative portfolio at FVPL, as explained in note 17. The Bank may designate financial instruments at FVPL if so doing eliminates or significantly reduces measurement or recognition inconsistencies.</p> <p>Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading and derivative instruments or the fair value designation is applied.</p> <p><b>Derecognition of financial assets</b> Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.</p>
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## 32. Analysis of financial assets and liabilities by measurement basis continued

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The principal accounting policies describe how financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the financial assets and liabilities in the balance sheet by the class of financial instrument to which they are assigned, and therefore by the measurement basis:

	Amortised cost £m	Fair value through OCI £m	Fair value through profit or loss £m	Other £m	Total £m
<b>At 28 February 2021</b>					
<b>Assets</b>					
Cash, balances with central banks and other demand deposits	968	–	–	–	968
Loans and advances to other banks	37	–	–	–	37
Derivative financial instruments	–	–	2	–	2
Investment securities	–	587	–	–	587
Loans and advances to customers	4,599	–	–	–	4,599
Investments in subsidiaries	–	–	–	325	325
Intangible assets	–	–	–	155	155
Property, plant and equipment	–	–	–	11	11
Other assets	744	–	–	10	754
	<b>6,348</b>	<b>587</b>	<b>2</b>	<b>501</b>	<b>7,438</b>
<b>Liabilities</b>					
Customer accounts	(5,128)	–	–	–	(5,128)
Other deposits	(1,161)	–	–	–	(1,161)
Other borrowed funds	–	–	–	–	–
Subordinated liabilities	(179)	–	–	–	(179)
Derivative financial instruments	–	–	(29)	–	(29)
Other liabilities	(81)	–	–	(3)	(84)
Provisions for liabilities and charges	(6)	–	–	(2)	(8)
	<b>(6,555)</b>	<b>–</b>	<b>(29)</b>	<b>(5)</b>	<b>(6,589)</b>

	Amortised cost £m	Fair value through OCI £m	Fair value through profit or loss <sup>1</sup> £m	Other £m	Total £m
<b>At 29 February 2020</b>					
<b>Assets</b>					
Cash, balances with central banks and other demand deposits	500	–	–	–	500
Loans and advances to other banks	40	–	–	–	40
Derivative financial instruments	–	–	6	–	6
Investment securities	–	853	–	–	853
Loans and advances to customers	6,511	–	–	–	6,511
Investments in subsidiaries	–	–	–	325	325
Intangible assets	–	–	–	234	234
Property, plant and equipment	–	–	–	38	38
Other assets	890	–	–	5	895
	<b>7,941</b>	<b>853</b>	<b>6</b>	<b>602</b>	<b>9,402</b>
<b>Liabilities</b>					
Customer accounts	(6,312)	–	–	–	(6,312)
Other deposits	(1,680)	–	–	–	(1,680)
Other borrowed funds	(101)	–	–	–	(101)
Subordinated liabilities	(180)	–	–	–	(180)
Derivative financial instruments	–	–	(35)	–	(35)
Other liabilities	(83)	–	–	(3)	(86)
Provisions for liabilities and charges	(8)	–	–	–	(8)
	<b>(8,364)</b>	<b>–</b>	<b>(35)</b>	<b>(3)</b>	<b>(8,402)</b>

<sup>1</sup> Travel Money, cash in ATMs and ATM cash in transit (included in Cash, balances with central banks and other demand deposits) of £315 million as at 29 February 2020 were previously classified as fair value through profit or loss and have been reclassified as amortised cost. The comparative disclosure has been updated to reflect this change. There were no changes to amounts recognised as a result of the classification due to the book value of cash equalling its fair value.

### 33. Leases

**Accounting policy** At inception of a contract, the Bank assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Bank uses the definition of a lease in IFRS 16.

The Bank leases office premises. The Bank recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Bank's incremental borrowing rate. Generally, the Bank uses its incremental borrowing rate as the discount rate. The Bank determines its incremental borrowing rate by analysing its borrowings from various external sources and makes certain adjustments to reflect the terms of the lease and type of asset leased.

Lease payments included in the measurement of the lease liability comprise fixed payments. The Bank is not party to any lease arrangements containing variable lease payments that depend on an index or a rate or amounts expected to be payable under a residual value guarantee. Lease payments in an optional renewal period are included where the Bank is reasonably certain to exercise an extension option.

Subsequently, the lease liability is adjusted for interest and lease payments. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Bank's estimate of the amount expected to be payable under the lease arrangements. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Bank presents right-of-use assets in property, plant and equipment (note 20) and lease liabilities in other liabilities (note 27) in the statement of financial position.

*Short-term leases and leases of low-value assets*

The Bank has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases, including leases of IT equipment. The Bank recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

#### Right-of-use assets

Right-of-use assets relate to leased office premises that are presented within property, plant and equipment (see note 20).

	Office building £m
Balance at 1 March 2019	4
Depreciation charge for the year	(1)
Balance at 29 February 2020	<b>3</b>
Lease modification	<b>1</b>
Depreciation charge for the year	<b>(1)</b>
Balance at 28 February 2021	<b>3</b>

The residual contractual maturity of lease liabilities is disclosed in note 35.

#### Amounts recognised in profit or loss

	2021 £m	2020 £m
Interest on lease liabilities (note 3)	<b>(1)</b>	(1)

#### Amounts recognised in statement of cash flows

	2021 £m	2020 £m
Total cash outflow for leases (see note 14)	<b>(2)</b>	–

### 34. Loan commitments

**Accounting policy** Undrawn Loan, Mortgage and Credit Card commitments are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer. These contracts are in scope of the ECL requirements and accounting policies in relation to this are detailed in note 13.

The nominal contractual value of these commitments, where the lending agreed to be provided is on market terms, are not recorded in the statement of financial position.

The contractual amount of the Bank's off-balance sheet financial instruments that commit it to extend credit to customers is as follows:

	2021 £m	2020 £m
Commitments to extend credit	<b>64</b>	80

The above table does not include undrawn limits on credit cards. These are not considered a contractual commitment but because in practice the Bank does not expect to withdraw these credit limits from customers, they are within the scope of impairment provisioning in the following table.

Reconciliation of impairment loss allowance of loan commitments

	Non-credit impaired		Credit- impaired	Total £m
	Stage 1 £m	Stage 2 £m	Stage 3 £m	
As at 1 March 2020	(4)	(3)	(1)	(8)
Transfers of financial assets:				
To Stage 1	–	–	–	–
To Stage 2	1	(1)	–	–
To Stage 3	–	–	–	–
Net transfer between stages	1	(1)	–	–
New loan commitments originated and increases to existing commitments <sup>1</sup>	–	–	–	–
Loan commitments expired	–	–	–	–
Changes in credit risk	–	2	–	2
As at 28 February 2021	(3)	(2)	(1)	(6)

	Non-credit impaired		Credit- impaired	Total £m
	Stage 1 £m	Stage 2 £m	Stage 3 £m	
As at 1 March 2019	(4)	(2)	(1)	(7)
Transfers of financial assets:				
To Stage 1	–	–	–	–
To Stage 2	1	(1)	–	–
To Stage 3	–	–	–	–
Net transfer between stages	1	(1)	–	–
New loan commitments originated and increases to existing commitments <sup>1</sup>	–	–	–	–
Loan commitments expired	1	–	–	1
Changes in credit risk	(2)	–	–	(2)
As at 29 February 2020	(4)	(3)	(1)	(8)

<sup>1</sup> This also reflects commitments which were originated in Stage 1 and subsequently moved to Stage 2 or Stage 3 during the year.

The loss allowance on loan commitments are recognised as part of provisions for liabilities (see note 28).

### 35. Risk management

The Bank encounters a range of different risks and uncertainties as it undertakes its day-to-day activities and seeks to achieve its strategic objectives. Our approach to risk management and an overview of the primary risk types are described in the Risk overview section on page 5. Further detail on credit and liquidity risk exposures are shown below, with capital adequacy discussed further in note 36.

#### Credit risk

Credit risk is central to the Bank's day to day activities and is managed in line with the Board approved risk appetite as detailed within the Principal risks section (page 7). Key developments over the course of the year were the response to COVID-19 as the pandemic evolved, including supporting the launch of Emergency Payment Freezes and the restart of retail lending.

#### Retail credit risk

Retail credit risk is the possibility of losses arising from a retail customer failing to meet their agreed repayment terms as they fall due. Retail Credit utilise automated scorecards to assess the credit worthiness and affordability criteria of new applicants and ongoing behavioural characteristics of existing customers. The outcome from all scorecard models is monitored utilising a set of credit quality metrics to ensure actual performance is in line with agreed expectations. Additional expert underwriting of credit applications is undertaken by a specialist operational team where further consideration is appropriate.

The Retail Credit Risk Committee provides portfolio oversight control over credit strategy to maintain lending in line with the Board approved risk appetite, with additional oversight and control provided by the Executive Risk Committee and Board Risk Committee. Internal Audit provide additional assurance by undertaking regular reviews on the adequacy of credit risk policies and procedures.

#### Wholesale and derivative credit risk

The Bank's treasury assets portfolio is held primarily for liquidity management purposes and in the case of derivatives, for the purpose of managing market risk. The treasury assets portfolio is invested in eligible investment securities that qualify for the regulatory Liquidity Coverage Ratio (LCR) and internal Operational Liquidity Pool (OLP). These investments include the Bank of England's (BoE) reserve account, UK government securities (gilts or Treasury bills), multilateral development bank securities, government guaranteed agency securities, covered bonds and asset backed securities.

Limits are established for all counterparty and asset class exposures based on their respective credit quality and market liquidity. Consideration is also given to geographical region and the strength of relevant sovereign credit ratings. Derivatives are subject to the same credit risk control procedures as are applied to other wholesale market instruments and the credit risk arising from mark-to-market derivative valuations is mitigated by daily margin calls, posting cash collateral to cover exposures. Daily monitoring is undertaken by the Bank's Treasury and Financial Risk teams, including early warning indicators with appropriate triggers for escalation.

At 28 February 2021, the maximum credit exposure of the Bank in the event of other parties failing to perform their obligations is equal to the sum of loans and advances to customers, loans and advances to banks, investment securities and credit lines and other commitments to lend. These are set out in notes 13, 16, 18 and 34 respectively. No account is taken of any collateral held and the maximum exposure to loss is considered to be the instrument's balance sheet carrying amount.

The table below shows the maximum exposure to credit risk for the components of the balance sheet, including derivatives. The maximum exposure is shown gross, before the effect of mitigation through the use of collateral agreements.

	2021 £m	2020 £m
<b>Credit risk exposures relating to on balance sheet items</b>		
Loans and advances to customers		
Unsecured	<b>3,344</b>	4,636
Secured	<b>1,255</b>	1,875
Cash and balances with central banks	<b>968</b>	500
Derivative financial instruments	<b>2</b>	6
Loans and advances to other banks <sup>1</sup>	<b>37</b>	40
Investment securities	<b>587</b>	853
Other assets	<b>744</b>	890
<b>Credit risk exposures relating to off balance sheet items</b>		
Loan commitments	<b>64</b>	80
<b>Total credit risk exposures</b>	<b>7,001</b>	8,880

<sup>1</sup> Reverse repurchase agreements have been presented in the new category 'Loans and advances to other banks'. In the prior year these were included in other assets, and the comparative figures have been reclassified.

## 35. Risk management continued

### Risk concentrations

Concentrations arise when a number of customers or counterparties are engaged in similar business activities, or activities in the geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank's performance to developments affecting a particular industry, counterparty or geographical location.

The Bank is a retail-focused financial institution operating solely in the UK. In line with its risk principles, the Bank seeks to actively identify and manage risk concentrations across its business areas and activities. It has set clear targets for diversification within its asset and liability portfolios and sources of income. These are supported by a range of portfolio limits and a focus on key processes and controls across its activities, systems and supply chain.

### Geographical sectors

	2021 £m	2020 £m
<b>Maximum exposure</b>		
United Kingdom	<b>6,673</b>	8,495
Europe	<b>172</b>	201
Other	<b>156</b>	184
	<b>7,001</b>	8,880

Concentration by location for investment securities is measured based on the location of the issuer of the security. The analysis reflects the credit risk associated with the balance and is not reflective of a currency exposure.

### Industry sectors

	2021 £m	2020 £m
<b>Maximum exposure</b>		
Retail	<b>4,663</b>	6,586
Financial institutions	<b>1,385</b>	1,841
Government	<b>953</b>	453
	<b>7,001</b>	8,880

### Credit quality per class of financial asset

Loans and advances are summarised as follows:

	2021 £m	2020 £m
Impaired	<b>148</b>	176
Past due but not impaired	<b>20</b>	28
Neither past due nor impaired	<b>4,582</b>	6,463
Gross amount due	<b>4,750</b>	6,667
Less: allowance for impairment	<b>(174)</b>	(183)
Hedging fair value adjustment	<b>23</b>	27
	<b>4,599</b>	6,511

## 35. Risk management continued

### Credit quality analysis

At 28 February 2021	Stage 1	Stage 2	Stage 3	Total
Unsecured lending	£m	£m	£m	£m
Impaired				
Less than 3 months, but impaired <sup>1</sup>	–	–	19	19
Over 3 months	–	–	25	25
Recoveries	–	–	93	93
Total gross impaired loans	–	–	137	137
Past due 30 days to 3 months	–	8	–	8
Past due less than 30 days	–	11	–	11
Not past due	2,903	444	–	3,347
Total gross amount due	2,903	463	137	3,503
Impairment				
Impairment on gross balance	(25)	(38)	(108)	(171)
Undrawn commitments impairment	(3)	(2)	(1)	(6)
Total impairment	(28)	(40)	(109)	(177)
Coverage	1.0%	8.6%	79.4%	5.1%

1 Includes £3 million of loans that would have been past due had their terms not been renegotiated.

At 28 February 2021	Stage 1	Stage 2	Stage 3	Total
Secured lending	£m	£m	£m	£m
Impaired				
Less than 3 months, but impaired <sup>1</sup>	–	–	10	10
Over 3 months	–	–	1	1
Recoveries	–	–	–	–
Total gross impaired loans	–	–	11	11
Past due 30 days to 3 months	–	–	–	–
Past due less than 30 days	–	1	–	1
Not past due	1,189	46	–	1,235
Total gross amount due	1,189	47	11	1,247
Impairment				
Impairment on gross balance	–	–	(3)	(3)
Undrawn commitments impairment	–	–	–	–
Total impairment	–	–	(3)	(3)
Coverage	0.02%	0.4%	19.7%	0.2%

1 Includes £3 million of loans that would have been past due had their terms not been renegotiated.

### 35. Risk management continued

At 29 February 2020 Unsecured lending	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Impaired				
Less than 3 months, but impaired <sup>1</sup>	–	–	13	13
Over 3 months	–	–	26	26
Recoveries	–	–	129	129
Total gross impaired loans	–	–	168	168
Past due 30 days to 3 months	–	10	–	10
Past due less than 30 days	–	17	–	17
Not past due	4,225	385	–	4610
Total gross amount due	4,225	412	168	4,805
Impairment				
Impairment on gross balance	(23)	(29)	(131)	(183)
Undrawn commitments impairment	(4)	(3)	(1)	(8)
Total impairment	(27)	(32)	(132)	(191)
Coverage	0.7%	7.7%	77.8%	4.0%

<sup>1</sup> Includes £4 million of loans that would have been past due had their terms not been renegotiated.

At 29 February 2020 Secured lending	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Impaired				
Less than 3 months, but impaired <sup>1</sup>	–	–	7	7
Over 3 months	–	–	1	1
Recoveries	–	–	–	–
Total gross impaired loans	–	–	8	8
Past due 30 days to 3 months	–	–	–	–
Past due less than 30 days	–	1	–	1
Not past due	1,778	75	–	1,853
Total gross amount due	1,778	76	8	1,862
Impairment				
Impairment on gross balance	–	–	–	–
Undrawn commitments impairment	–	–	–	–
Total impairment	–	–	–	–
Coverage	0.0%	0.0%	3.6%	0.02%

<sup>1</sup> Includes £3 million of loans that would have been past due had their terms not been renegotiated.

Mortgages held over residential properties represent the only collateral held by the Bank for retail exposures. The market value of collateral held for impaired loans and loans past due but not impaired was £26 million (2020: £19 million). The fair value of collateral held against possession cases was £nil (2020: £nil).

If a customer falls into arrears, the customer will be held in 'collections' where the Bank will work with the customer to try and regularise the position over a period of time. Where the arrears status of a customer deteriorates and there is a failure to respond to correspondence or agree an acceptable repayment proposal, including notice of default, the customer balance will fall into 'recoveries'. A specialist debt recovery team will take steps to recover the debt, using their expertise to determine the optimum recovery strategy.

#### Collateral

The Bank holds collateral against loans and advances to customers in the form of Mortgages over residential property and second charges over business assets, including commercial and residential property.

## 35. Risk management continued

### Credit quality

The Bank defines the following classifications for all credit exposures: High, Satisfactory, Low and Credit impaired. These are segmented by 12 month probability of default (PD) under IFRS 9. Unsecured lending represents credit cards and personal loan lending at 28 February 2021. Secured lending represents mortgage lending.

	IFRS 9 12 month PD
High quality:	<=3.02%
Satisfactory quality	>3.02%; < 11.11%
Low quality	>= 11.11%
Credit impaired	100%

### Unsecured lending

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<b>28 February 2021</b>				
High quality	<b>2,683</b>	<b>161</b>	–	<b>2,844</b>
Satisfactory quality	<b>214</b>	<b>240</b>	–	<b>454</b>
Low quality	<b>6</b>	<b>62</b>	–	<b>68</b>
Credit impaired	–	–	<b>137</b>	<b>137</b>
Total gross amount due	<b>2,903</b>	<b>463</b>	<b>137</b>	<b>3,503</b>

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<b>29 February 2020</b>				
High quality	3,948	112	–	4,060
Satisfactory quality	273	240	–	513
Low quality	4	60	–	64
Credit impaired	–	–	168	168
Total gross amount due	4,225	412	168	4,805

### Secured lending

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<b>28 February 2021</b>				
High quality	<b>1,189</b>	<b>45</b>	–	<b>1,234</b>
Satisfactory quality	–	<b>2</b>	–	<b>2</b>
Low quality	–	<b>0</b>	–	<b>0</b>
Credit impaired	–	–	<b>11</b>	<b>11</b>
Total gross amount due	<b>1,189</b>	<b>47</b>	<b>11</b>	<b>1,247</b>

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<b>29 February 2020</b>				
High quality	1,778	73	–	1,851
Satisfactory quality	–	1	–	1
Low quality	–	2	–	2
Credit impaired	–	–	8	8
Total gross amount due	1,778	76	8	1,862

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

	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<b>At 28 February 2021</b>				
Less than 70%	<b>795</b>	<b>37</b>	<b>8</b>	<b>840</b>
70% to 80%	<b>265</b>	<b>7</b>	<b>2</b>	<b>274</b>
80% to 90%	<b>128</b>	<b>3</b>	<b>1</b>	<b>132</b>
90% to 100%	<b>1</b>	<b>0</b>	<b>0</b>	<b>1</b>
Greater than 100%	–	–	–	–
<b>Total mortgages</b>	<b>1,189</b>	<b>47</b>	<b>11</b>	<b>1,247</b>

### 35. Risk management continued

At 29 February 2020	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
Less than 70%	1,032	45	6	1,083
70% to 80%	377	12	1	390
80% to 90%	304	16	1	321
90% to 100%	65	3	–	68
Greater than 100%	–	–	–	–
Total mortgages	1778	76	8	1,862

The following table shows the maximum exposure to credit risk for commitments and balances measured at amortised cost along with the related amounts which are credit impaired at the reporting date:

	2021		2020	
	Maximum exposure to credit risk £m	Of which secured by collateral – residential property £m	Maximum exposure to credit risk £m	Of which secured by collateral – residential property £m
<b>Loan commitments</b>	<b>6,422</b>	–	5,596	14
Of which credit impaired	<b>25</b>	–	28	–
<b>Financial assets measured at amortised cost – retail lending</b>	<b>4,750</b>	<b>1,247</b>	6,667	1,862
Of which credit impaired	<b>148</b>	<b>11</b>	176	8
<b>Total</b>	<b>11,172</b>	<b>1,247</b>	12,263	1,876
Of which credit impaired	<b>173</b>	<b>11</b>	204	8

#### Forbearance

The Bank provides support to customers who are experiencing financial difficulties. Forbearance is relief granted by a lender to assist customers in financial difficulty, through arrangements which temporarily allow the customer to pay an amount other than the contractual amounts due. These temporary arrangements may be initiated by the customer or the Bank where financial difficulty would prevent repayment within the original terms and conditions of the contract.

The main aim of forbearance is to support customers in returning to a position where they are able to meet their contractual obligations. The Bank has adopted the definition of forbearance as published in Regulation EU 2015/227. The Bank reports all accounts meeting this definition, providing for them appropriately.

The Bank has well defined forbearance policies and processes. A number of forbearance options are made available to customers. These include, arrangements to repay arrears over a period of time, by making payments above the contractual amount, that ensure the loan is repaid within the original repayment term and short-term concessions, where the borrower is allowed to make reduced repayments (or in exceptional circumstances, no repayments) on a temporary basis to assist with short-term financial hardship.

The table below details the values of secured and unsecured advances that are subject to forbearance programmes, in accordance with the European Banking Authority (EBA) definition.

	2021			2020		
	Gross loans and advances subject to forbearance £m	Forbearance as a total loans and advances %	Forbearance covered by impairment provision %	Gross loans and advances subject to forbearance £m	Forbearance as a total loans and advances %	Forbearance covered by impairment provision %
Unsecured	<b>22</b>	<b>0.6</b>	<b>55.3</b>	28	0.6	57.7
Secured	<b>4</b>	<b>0.3</b>	<b>24.6</b>	4	0.2	4.2
<b>Total</b>	<b>26</b>	<b>0.5</b>	<b>50.9</b>	32	0.5	51.7

### 35. Risk management continued

#### Emergency Payment Freeze (EPF)

The tables below shows live EPFs at 28 February 2021 provided in response to COVID-19 for both secured and unsecured lending, including any agreed second payment holidays. The table excludes cases which have been completed prior to this date.

	Gross lending on EPF				Proportion as a total of loans and advances				ECL			
	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m	Stage 1 %	Stage 2 %	Stage 3 %	Total %	Stage 1 £m	Stage 2 £m	Stage 3 £m	Total £m
<b>28 February 2021</b>												
Unsecured	13	9	2	24	0.5	2.0	1.1	0.7	–	1	1	2
Secured	9	–	–	9	0.8	0.3	–	0.7	–	–	–	–

#### Debt securities, balances with central banks and other eligible investment securities

The total gross amount of individually impaired debt securities, cash and balances with central banks, UK government securities (Gilts and Treasury bills) and other eligible investment securities as at 28 February 2021 was £nil (2020: £nil). The tables below present an analysis of the credit quality of cash and cash equivalents and the treasury assets portfolio by market value. Analysis is by rating agency designation, based on Moody's ratings:

	Cash and balances with central banks £m	UK government securities £m	Other investment securities £m	Total £m
<b>At 28 February 2021</b>				
Aaa to A3	–	–	<b>587</b>	<b>587</b>
ATM cash and balances with central banks	<b>936</b>	–	–	<b>936</b>
Other demand deposits	<b>31</b>	–	–	<b>31</b>
	<b>967</b>	–	<b>587</b>	<b>1,554</b>

	Cash and balances with central banks £m	UK government securities £m	Other investment securities £m	Total £m
<b>At 29 February 2020</b>				
Aaa to A3	–	51	802	853
ATM cash and balances with central banks	426	–	–	426
Other demand deposits	74	–	–	74
	500	51	802	1,353

#### Credit risk profile by external rating grades of treasury assets measured at FVOCI

	2021		2020	
	Non-credit impaired	Total gross carrying amount	Non-credit impaired	Total gross carrying amount
	Stage 1 £m	£m	Stage 1 £m	£m
<b>External rating grades</b>				
Aaa to A3	<b>587</b>	<b>587</b>	853	853
	<b>587</b>	<b>587</b>	853	853

### 35. Risk management continued

#### Financial assets and liabilities subject to offsetting, master netting agreements and similar agreements

The following table shows financial instruments which are subject to offsetting, master netting and similar agreements:

Net amounts At 28 February 2021	Gross assets/ (liabilities) recognised £m	Amounts offset £m	Net amounts recognised in the balance sheet £m	Related amounts not offset in the balance sheet		
				Financial instruments £m	Collateral pledged/ (received) £m	£m
Derivative financial instruments – assets	8	(6)	2	–	(2)	–
Derivative financial instruments – liabilities	(35)	6	(29)	–	30	1
	(27)	–	(27)	–	28	1

Net amounts At 29 February 2020	Gross assets/ (liabilities) recognised £m	Amounts offset £m	Net amounts recognised in the balance sheet £m	Related amounts not offset in the balance sheet		
				Financial instruments £m	Collateral pledged/ (received) £m	£m
Derivative financial instruments – assets	6	–	6	–	–	6
Derivative financial instruments – liabilities	(35)	–	(35)	–	27	(8)
	(29)	–	(29)	–	27	(2)

The Bank has derivatives which are governed by the International Swaps and Derivatives Association (ISDA), credit support annex (CSA) and cleared derivatives execution agreement (CDEA) whereby if the fair value exceeds a pre-agreed level, cash collateral is exchanged. The Bank's exposures are held with a central clearing counterparty, the London Clearing House (LCH), the terms of which also required an initial margin to be provided. At 28 February 2021, the Bank had posted cash collateral of £30 million (2020: £28 million) and received cash collateral of £2 million (2020: £nil) against its derivative positions, and £25 million of initial margin collateralised by encumbered Gilts (2020: £43 million of initial margin collateralised by encumbered Gilts). The Bank has also pledged and encumbered cash collateral of \$58.5 million (2020: \$58.4 million) to MasterCard against the risk of issuing merchant spend credit.

#### Liquidity and funding risk

Liquidity risk is the risk that the Bank cannot meet its payment obligations as they fall due or can only do so at excessive cost. The Bank seeks to ensure that financial obligations can be met at all times, even under liquidity stress conditions.

The annual Internal Liquidity Adequacy Assessment Process (ILAAP) enables the Bank to:

- (1) Identify and assess its most relevant liquidity risk drivers
- (2) Quantify its liquidity needs under various stress scenarios and
- (3) Put in place appropriate limits and controls to mitigate liquidity risks.

In meeting its internal limits as well as PRA requirements, the Bank maintains a stock of high quality liquid assets that can be readily monetised by outright sale or repurchase agreement to meet the Bank's obligations to depositors and other creditors.

The Bank's Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are regularly monitored and forecast alongside cash flow and funding ratios. Treasury prepare long-term and short-term forecasts to assess liquidity requirements, taking into account factors such as ATM cash management, contractual maturities and customer deposit patterns (stable or less stable deposits) as well as outflows regarding undrawn commitments. These reports support daily liquidity management, with early warning indicators reviewed on a daily basis and appropriate triggers for escalation and action in line with risk appetite, Liquidity and Funding Policy and Liquidity Contingency Plan. Asset encumbrance ratios and key risk indicators for wholesale funding are also regularly monitored and reported to ALCO.

The table on the following page shows the undiscounted cash flows on the Bank's financial assets, liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. The expected (behavioural) cash flows on these instruments vary significantly from this analysis and as such are regularly modelled to ensure operational net cash flows are managed. The disclosure for derivatives shows a gross inflow and outflow amount. As derivatives have a simultaneous net settlement it is not considered representative to show only the outflow amount.

Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history.

## 35. Risk management continued

### Residual contractual maturity analysis

At 28 February 2021	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
<b>Assets</b>						
<i>Non-derivative assets</i>						
Loans and advances to customers	1,626	324	669	1,532	1,368	5,519
Cash and balances at central banks	968	–	–	–	–	968
Loans and advances to other banks	27	–	10	–	–	37
Investment securities	21	34	102	435	–	592
Other assets	726	–	–	–	–	726
Long-term interest receivable	1	1	5	13	–	20
	<b>3,369</b>	<b>359</b>	<b>786</b>	<b>1,980</b>	<b>1,368</b>	<b>7,862</b>
Net derivative asset cash flows	–	–	1	5	–	6
Total cash inflows	<b>3,369</b>	<b>359</b>	<b>787</b>	<b>1,985</b>	<b>1,368</b>	<b>7,868</b>
<b>Liabilities</b>						
<i>Non-derivative liabilities</i>						
Customer accounts	4,561	79	285	207	–	5,132
Other deposits	157	86	920	–	–	1,163
Subordinated debt	–	5	5	186	–	196
Lease liabilities	–	–	1	2	2	5
Other liabilities (excluding lease liabilities)	76	–	–	–	–	76
	<b>4,794</b>	<b>170</b>	<b>1,211</b>	<b>395</b>	<b>2</b>	<b>6,572</b>
Net derivative liability cash flows	2	3	12	23	0	40
Unrecognised loan commitments	64	–	–	–	–	64
Total cash outflows	<b>4,860</b>	<b>173</b>	<b>1,223</b>	<b>418</b>	<b>2</b>	<b>6,676</b>
Net liquidity	<b>(1,491)</b>	<b>186</b>	<b>(436)</b>	<b>1,567</b>	<b>1,366</b>	<b>1,192</b>
<b>At 29 February 2020</b>						
	Less than 1 month £m	1 to 3 months £m	3 to 12 months £m	1 to 5 years £m	Over 5 years £m	Total £m
<b>Assets</b>						
<i>Non-derivative assets</i>						
Loans and advances to customers	2,096	404	876	2,291	2,446	8,113
Cash and balances at central banks	500	–	–	–	–	500
Investment securities	51	6	100	714	–	871
Other assets	919	1	5	20	–	945
	3,566	411	981	3,025	2,446	10,429
Net derivative asset cash flows	2	9	16	35	–	62
Total cash inflows	3,568	420	997	3,060	2,446	10,491
<b>Liabilities</b>						
<i>Non-derivative liabilities</i>						
Customer accounts	5,530	129	405	260	–	6,324
Other deposits	372	78	289	956	–	1,695
Other borrowed funds	13	20	68	–	–	101
Subordinated debt	–	5	5	196	–	206
Lease liabilities	–	–	1	4	–	5
Other liabilities (excluding lease liabilities)	81	–	–	–	–	81
	5,996	232	768	1,416	–	8,412
Net derivative liability cash flows	4	7	29	50	2	92
Unrecognised loan commitments	80	–	–	–	–	80
Total cash outflows	6,080	239	797	1,466	2	8,584
Net liquidity	(2,512)	181	200	1,594	2,444	1,907

### 35. Risk management continued

#### Asset encumbrance

An asset is defined as encumbered if it has been pledged as collateral against a recognised or off balance sheet liability and therefore is no longer available for disposal or as collateral to support liquidity or funding requirements of the Bank. The encumbrance levels of assets and related recognised or off balance sheet liabilities are shown in the following tables:

	Encumbered £m	Unencumbered £m	Total £m
<b>At 28 February 2021</b>			
Loans and advances to customers	1,596	3,003	4,599
Debt securities	27	560	587
Other assets	76	678	754
Cash and balances with central banks	17	951	968
	<b>1,716</b>	<b>5,191</b>	<b>6,908</b>

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	1,596	1,110
Debt securities	27	–
Other assets	76	27
Cash and balances with central banks	17	–
	<b>1,716</b>	<b>1,137</b>

	Encumbered £m	Unencumbered £m	Total £m
<b>At 29 February 2020</b>			
Loans and advances to customers	1,774	4,737	6,511
Debt securities	339	514	853
Other assets	76	859	935
Cash and balances with central banks	18	482	500
	2,207	6,592	8,799

	Carrying value of encumbered assets £m	Matching liabilities, contingent liabilities or securities lent £m
Loans and advances to customers	1,774	1,126
Debt securities	339	299
Other assets	76	29
Cash and balances with central banks	18	–
	2,207	1,454

The main sources of encumbrance in the Bank relate to margin requirements for derivative transactions and collateral relating to secured funding transactions. Cash collateral is advanced and received as variation margin on derivatives transactions, whilst eligible treasury assets are pledged as collateral for initial margin requirements on derivatives which are centrally cleared. Eligible personal and mortgage loans with applicable haircuts are used as collateral for the bilateral personal loans securitisation facility and the Bank of England's Term Funding Scheme (TFS) and Indexed Long-term Repo (ILTR). The personal loans and mortgages used to secure the funding are held within Loans and advances to customers. There are assets which would not normally be considered available for encumbrance in the normal course of the Bank's business including intangible assets, property, plant and equipment, prepayments and accruals and deferred tax assets. These are included within the carrying value of unencumbered assets.

## 35. Risk management continued

### Market risk

Market risk is the risk that the value of the Bank's assets, liabilities, capital and earnings are exposed to the adverse change of the market risk drivers. The Bank's market risks include Interest Rate Risk in the Banking Book (IRRBB) and Foreign Exchange (FX) risk. The Bank does not have a trading book.

### Interest rate risk

IRRBB arises from interest rate movements which impact present value and timing of future cash flows resulting in changes in the underlying value of a bank's assets, liabilities and off-balance sheet instruments and hence its economic value. Interest rates movements also affect a bank's earnings by altering interest-sensitive income and expenses, affecting its net interest income.

The main types of interest rate risk faced by the Bank are:

**Re-pricing gap risk:** the risk arising from timing differences in the interest rate changes of bank assets and liabilities (e.g. fixed rate personal loans and instant access savings accounts).

**Yield curve risk:** the risk arising from changes in the slope and shape of the yield curve.

**Basis risk:** risk arising from imperfect correlation between different interest rate indices (e.g. administered rate on savings products and treasury assets linked to LIBOR).

**Prepayment risk:** the risk arising from the timing of customer prepayments which differ from planning and hedging assumptions.

**Pipeline risk:** the risk of a customer drawing down, or not, a product at a rate which is unfavourable for the Bank.

**Credit spread risk:** the risk of adverse effects resulting from a change in credit spreads, arising via the Bank's treasury assets portfolio.

Interest risk exposure is actively managed within limits that are aligned with the Bank's risk appetite by using financial instruments such as interest rate swaps and by taking into account natural hedges between assets and liabilities with similar re-pricing characteristics. Hedging strategies are implemented and reviewed to ensure the Bank remains within its limits.

In order to measure the exposure to interest rate risk the Bank adopts a Capital at Risk ('CaR') approach to assess the value sensitivity of the Bank's capital to movements in interest rates under various interest rates shock scenarios, as well as via an annual earnings at risk metric which measures the sensitivity of the Bank's earnings to movements in interest rates over a 12 month period. The CaR measure is an aggregate measure of five separate risk components, each being a distinct form of interest rate risk including re-pricing risk, basis risk, prepayment risk, MTM risk and credit spread risk.

For interest rate risk measurement, all products are allocated within a re-pricing gap analysis based on their nearest re-pricing date (all non-maturing deposits are assumed to re-price in month one) and where applicable using a customer behavioural repayment profile.

As at 28 February 2021 earnings at risk (change in net interest income) for changes in interest rates of +/-100 basis points movements in rates are as follows:

	2021 £m	2020 £m
+/- 100 basis points	<b>(7)/4</b>	(17)/19

The above analysis assumes that interest rates would floor at 0% and would not result in negative rates becoming applicable.

### Foreign exchange risk

The Bank is exposed to FX risk through its holding of cash denominated in foreign currencies, primarily Euro and US Dollar, within its Travel Money Bureaux in J Sainsbury's stores. The Bank also has exposures in US Dollar for the cash collateral pledged to MasterCard. Foreign exchange risk is currently mitigated through forward rate transactions. However it is noted that during the COVID-19 pandemic Travel Money Bureaux were closed and hence the exposure to foreign exchange risk is reduced. Further details of the hedging arrangements in place at year end are disclosed in note 17.

### 36. Capital resources

From a prudential perspective, the Bank is monitored and supervised on a consolidated basis with its subsidiary, Home Retail Group Card Services Limited, from the point of acquisition of Argos Financial Services in September 2016. The Bank has obtained an individual consolidation waiver from the PRA, which allows the Bank to monitor its capital position on a consolidated basis only. Therefore, the capital position shown below is on a regulatory consolidated basis. The following table analyses the regulatory capital resources under CRD IV and aligns to the phase-in approach of IFRS 9 impacts on capital, over a five-year period from 1 March 2018.

	Transitional 2021 IFRS 9 £m	Full impact 2021 IFRS 9 £m	Transitional 2020 IFRS 9 £m	Full impact 2020 IFRS 9 £m
<b>Common Equity Tier 1 (CET1) capital:</b>				
Ordinary share capital	901	901	901	901
Allowable reserves (unaudited – including subsidiary undertakings)	(44)	(44)	93	93
<b>CET1 capital pre regulatory adjustments</b>	<b>857</b>	<b>857</b>	994	994
<b>Regulatory adjustments:</b>				
Intangible assets (including subsidiary undertakings)	(130)	(130)	(237)	(237)
Additional value adjustment	(1)	(1)	(1)	(1)
Transitional adjustment	65	–	66	–
<b>Total regulatory adjustments to CET1 capital</b>	<b>(66)</b>	<b>(131)</b>	(172)	(238)
<b>Tier 1 capital</b>	<b>791</b>	<b>726</b>	822	756
Loan notes (listed)	120	119	167	167
<b>Tier 2 capital</b>	<b>120</b>	<b>119</b>	167	167
<b>Total capital</b>	<b>911</b>	<b>845</b>	989	923

The movement of CET1 capital during the financial year is analysed as follows:

	Transitional 2021 IFRS9 £m	Full impact 2021 IFRS9 £m	Transitional 2020 IFRS9 £m	Full impact 2020 IFRS9 £m
At 1 March	822	756	785	706
Ordinary share capital issued	–	–	35	35
IFRS 9 adjustment to retained earnings (including subsidiary undertakings)	–	–	–	–
Verified profit/(losses) (including subsidiary undertakings)	(142)	(142)	20	20
Transitional adjustments	(1)	–	(13)	–
Other reserve movements	5	5	7	7
Movement in additional value adjustments	–	–	–	–
Movement in intangible assets	107	107	(12)	(12)
As at 28/29 February	791	726	822	756

#### Reconciliation of statutory reserves to regulatory reserves

	2021 £m	2020 £m
Total shareholders' funds	849	1,000
Total shareholders' funds of subsidiary undertakings and consolidation adjustments	8	(6)
Regulatory adjustments	(66)	(172)
CET1 capital	791	822

## 36. Capital resources continued

### Leverage ratio (unaudited)

The leverage ratio is defined as the ratio of Tier 1 capital to adjusted assets, which is measured below on a regulatory consolidated basis. The denominator represents the total non-risk weighted assets of the regulatory group (Bank and Home Retail Group Card Services Limited) adjusted for certain off balance sheet exposure assets and regulatory deductions and provides a non-risk-weighted 'backstop' capital measure. The leverage ratio is calculated below as at 28 February 2021. The Bank's leverage ratio of 9.5% (2020: 8.1%), exceeds the minimum Basel leverage ratio of 3%.

	Transitional 2021 IFRS 9 £m	Full impact 2021 IFRS 9 £m	Transitional 2020 IFRS 9 £m	Full impact 2020 IFRS 9 £m
<b>Components of the leverage ratio</b>				
Total assets as per published financial statements	<b>7,438</b>	<b>7,438</b>	9,402	9,402
Uplift on consolidation of subsidiary undertakings	<b>58</b>	<b>58</b>	59	59
Exposure value for derivatives and SFTs	<b>22</b>	<b>22</b>	15	15
Off balance sheet exposures: unconditionally cancellable (10%)	<b>917</b>	<b>917</b>	906	906
Off balance sheet: other (100%)	<b>13</b>	<b>13</b>	16	16
Other adjustments	<b>(79)</b>	<b>(143)</b>	(238)	(238)
	<b>8,369</b>	<b>8,305</b>	10,160	10,160
Tier 1 capital	<b>791</b>	<b>726</b>	822	756
Leverage ratio	<b>9.5%</b>	<b>8.7%</b>	8.1%	7.4%

### Capital management

The Bank manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of its activities. Capital adequacy is monitored on an ongoing basis by senior management, the ALCo, the Executive Risk Committee and the Board Risk Committee. Our submissions to the PRA in the year have shown that the Bank has complied with all externally imposed capital requirements.

The Bank will disclose Pillar 3 information as required by the Capital Requirements Regulations and PRA prudential sourcebook on the J Sainsbury plc external website.

## 37. Fair value of financial instruments

### Fair value hierarchy

IFRS 13 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources; unobservable inputs reflect the Bank's market assumptions. These two types of inputs have created the following fair value hierarchy:

#### Level 1

Quoted prices (unadjusted) in active markets for identical assets or liabilities. This level includes listed equity securities and debt instruments on exchanges (for example, London Stock Exchange, Frankfurt Stock Exchange, New York Stock Exchange) and exchange traded derivatives like futures.

#### Level 2

Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). The sources of input parameters like LIBOR yield curve or counterparty credit risk are Bloomberg and Reuters.

#### Level 3

Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes equity investments and debt instruments with significant unobservable components. This hierarchy requires the use of observable market data when available. The Bank considers relevant and observable market prices in its valuations where possible.

### 37. Fair value of financial instruments continued

The below table provides an analysis of the relevant fair value hierarchy for items recognised at fair value:

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>At 28 February 2021</b>				
Derivatives designated as fair value hedging instruments	–	–	–	–
Derivatives not in fair value hedging relationships	–	2	–	2
Investment securities	586	1	–	587
<b>Total assets</b>	<b>586</b>	<b>3</b>	<b>–</b>	<b>589</b>
Derivatives designated as fair value hedging instruments	–	29	–	29
Derivatives not in fair value hedging relationships	–	–	–	–
<b>Total liabilities</b>	<b>–</b>	<b>29</b>	<b>–</b>	<b>29</b>
<b>At 29 February 2020</b>				
Derivatives designated as fair value hedging instruments	–	6	–	6
Derivatives not in fair value hedging relationships	–	–	–	–
Investment securities	853	–	–	853
<b>Total assets</b>	<b>853</b>	<b>6</b>	<b>–</b>	<b>859</b>
Derivatives designated as fair value hedging instruments	–	35	–	35
Derivatives not in fair value hedging relationships	–	–	–	–
<b>Total liabilities</b>	<b>–</b>	<b>35</b>	<b>–</b>	<b>35</b>

The table on the following page summarises the fair value of financial assets and liabilities that are not presented in the Bank's balance sheet at fair value. The fair values of financial instruments are based on market prices where available, or are estimated using other valuation techniques. Where they are short term in nature or re-price frequently, fair value approximates to carrying value. The fair value information presented does not represent the fair value of the Bank as a going concern at 28 February 2021 or 29 February 2020.

	2021		2020	
	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
<b>Assets:</b>				
Loans and advances to customers	4,599	4,576	6,511	6,515
Cash and balances at central banks	968	968	500	500
Loans and advances to other banks	37	37	40	40
<b>Liabilities:</b>				
Customer accounts	5,128	5,137	6,312	6,319
Other deposits	1,161	1,161	1,680	1,680
Other borrowed funds	–	–	101	101
Subordinated debt	179	183	180	186

### 37. Fair value of financial instruments continued

The carrying value of other assets and other liabilities is a reasonable approximation of fair value.

The fair value hierarchy classification adopted by the Bank in respect of assets not presented in the Bank's balance sheet at fair value is shown in the following table:

	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
<b>At 28 February 2021</b>				
Loans and advances to customers	–	4,576	–	4,576
Cash and balances at central banks	–	968	–	968
Loans and advances to other banks	–	37	–	37
<b>Total assets</b>	<b>–</b>	<b>5,581</b>	<b>–</b>	<b>5,581</b>
Customer accounts	–	5,137	–	5,137
Other deposits	–	1,161	–	1,161
Other borrowed funds	–	–	–	–
Subordinated debt	183	–	–	183
<b>Total liabilities</b>	<b>183</b>	<b>6,298</b>	<b>–</b>	<b>6,481</b>
<b>At 29 February 2020</b>				
Loans and advances to customers	–	6,515	–	6,515
Cash and balances at central banks	–	500	–	500
Loans and advances to other banks	–	40	–	40
<b>Total assets</b>	<b>–</b>	<b>7,055</b>	<b>–</b>	<b>7,055</b>
Customer accounts	–	6,319	–	6,319
Other deposits	–	1,680	–	1,680
Other borrowed funds	–	101	–	101
Subordinated debt	186	–	–	186
<b>Total liabilities</b>	<b>186</b>	<b>8,100</b>	<b>–</b>	<b>8,286</b>

Information on how fair values are calculated for the financial assets and liabilities noted above is explained within the critical accounting estimates section of the accounting policies.

The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates to determine fair value.

For fixed interest bearing deposits and other borrowings without quoted market price, valuations are based on discounted cash flows using market interest rates for new lending with similar remaining maturity. The estimated fair value of deposits with no stated maturity is the amount repayable on demand.

### 38. Parent company

The immediate and ultimate parent company and controlling party of the Bank is J Sainsbury plc, which is registered in England. Its registered office is 33 Holborn, London, EC1N 2HT. J Sainsbury plc forms the only group into which the financial statements of the Bank are consolidated. Copies of the parent company's financial statements may be obtained from [www.j-sainsbury.co.uk](http://www.j-sainsbury.co.uk).

### 39. Share-based payments

**Accounting policy** The Bank, through schemes operated by its parent company J Sainsbury plc, provides benefits to employees (including Directors) of the Bank in the form of equity-settled and cash-settled share-based payment transactions, whereby employees render services in exchange for shares, rights over shares or the value of those shares in cash terms.

For equity-settled share-based payments the fair value of the employee services rendered is determined by reference to the fair value of the shares awarded or options granted, excluding the impact of any non-market vesting conditions. All share options are valued using an option-pricing model (Black-Scholes or Monte Carlo). This fair value is charged to the income statement over the vesting period of the share-based payment scheme with a corresponding increase to equity.

#### Income statement

The Bank recognised £2.9 million (2020: £3.6 million) of employee costs (note 6) related to share-based payment transactions made during the financial year. Of these, £nil (2020: £nil) were cash-settled.

The parent company, J Sainsbury plc, operates various share-based payment schemes, in which employees of the Bank participate, as set out on the following pages:

### 39. Share-based payments continued

#### a. Savings Related Share Option Scheme ('SAYE')

The Group operates a Savings Related Share Option Scheme, which is open to all UK employees with more than three months' continuous service. This is an approved HMRC Scheme and was established in 1980. Under the SAYE scheme, participants remaining in the Group's employment at the end of the three-year or five-year savings period are entitled to use their savings to purchase shares in J Sainsbury plc at a stated exercise price. Employees leaving for certain reasons are able to use their savings to purchase shares within six months of their leaving.

A reconciliation of Sharesave option movements is shown below:

	2021 Number of options million	2021 Weighted average exercise price pence	2020 Number of options million	2020 Weighted average exercise price pence
Outstanding at beginning of year	1.2	189	1.1	213
Granted	0.3	161	0.5	161
Forfeited	(0.2)	199	(0.3)	228
Exercised	(0.2)	185	(0.1)	187
Outstanding at end of year	1.1	179	1.2	189
Exercisable at end of year	0.1	185	0.1	185
Exercisable price range		161 to 260		161 to 260

The weighted average share price of J Sainsbury plc during the period for options exercised over the year was 215 pence (2020: 209 pence). The weighted average remaining contractual life of share options outstanding at 28 February 2021 was 2.6 years (2020: 2.8 years). Options granted during the year were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted during the year and the assumptions used in the calculation are as follows:

	2021	2020
Share price at grant date (pence)	226	220
Exercise price (pence)	161	161
Expected volatility – 3 year period (%)	29.9	24.5
– 5 year period (%)	–	26.9
Option life – 3 year period (years)	3.2	3.2
– 5 year period (years)	–	5.2
Expected dividends (expressed as dividend yield %)	5.2	2.9
Risk-free interest rate – 3 year period (%)	0.11	0.9
– 5 year period (%)	–	1.3
Fair value per option – 3 year period (pence)	55	53
– 5 year period (pence)	–	62

The expected volatility is based on the standard deviation of J Sainsbury plc's share price for the period immediately prior to the date of grant of award, over the period identical to the vesting period of the award, adjusted for management's view of future volatility of the share price.

#### b. Long-Term Incentive Plan

Under the Long-Term Incentive Plan, shares in J Sainsbury plc are conditionally awarded to the senior managers in the Company. The core awards are calculated as a percentage of the participants' salaries and scaled according to grades.

Performance is measured at the end of the three-year performance period. If the required performance conditions have been met, the awards vest and 50% of the award will be released. Subject to participants remaining in employment for a further year, the balance will then be released one year after the vesting date. Options granted to acquire the award of shares will expire five years from the grant date. Dividends will accrue on the shares that vest in the form of additional shares.

The core award can grow by up to four times, dependent on the level of performance. Straight-line vesting will apply if performance falls between two points. Awards are structured as nil cost options.

A reconciliation of the number of shares conditionally allocated is shown below:

	2021 Million	2020 Million
Outstanding at beginning of year	1.4	1.0
Conditionally allocated	0.9	1.0
Forfeited	(0.1)	(0.1)
Exercised	(0.7)	(0.5)
Outstanding at end of year	1.5	1.4

The weighted average remaining contractual life of share options outstanding at 28 February 2021 was 1.4 years (2020: 2.3 years).

### 39. Share-based payments continued

Details of shares conditionally allocated at 28 February 2021 are set out below:

Date of conditional award	2021 million	2020 million
12 May 2016 (2016 Future Builder)	0.0	0.3
11 May 2017 (2017 Future Builder)	0.3	0.3
11 May 2018 (2018 Future Builder)	0.3	0.3
9 May 2019 (2019 Future Builder)	0.4	0.4
3 July 2019 (2019 Future Builder)	0.0	0.0
29 July 2019 (2019 Future Builder)	0.1	0.1
7 May 2020 (2020 Future Builder)	0.4	–
	<b>1.5</b>	1.4

Options to acquire the award of shares were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted during the year and the assumptions used in the calculation are as follows:

	2021	2020
Share price at grant date (pence)	199	219
Option life (years)	4.0	4.0
Fair value per option (pence)	199	219

The weighted average share price during the year for options exercised was 196 pence (2020: 213 pence).

#### c. Deferred Share Award

The Deferred Share Award targets a diverse range of financial and strategic scorecard measures. These are intended to reward the top managers in the Group, including Executive Directors, for driving the short-term objectives that will directly lead to building the sustainable, long-term growth of the Group. Awards are structured as nil cost options.

Share-based awards are made to participants subject to performance against a basket of measures. At least 50% of the awards are based on the delivery of financial performance and returns to shareholders. The balances are based on measures which will assess the Group's performance relative to its competitors as well as key strategic goals.

Performance against the target is measured over one financial year, but any shares awarded are deferred for a further two years to ensure that management's interests continue to be aligned with those of shareholders. The shares are subject to forfeiture if the participant resigns or is dismissed for cause prior to their release date. Dividends accrue on the shares that vest in the form of additional shares.

A reconciliation of the number of shares granted over the year is shown below:

	2021 million	2020 million
Outstanding at beginning of year	0.4	0.3
Granted	0.3	0.3
Exercised	(0.2)	(0.2)
Outstanding at end of year	0.5	0.4

The number of shares allocated at the end of the year is set out below:

	Shares conditionally allocated 2021 million	Shares conditionally allocated 2020 million
11 May 2018	–	0.2
9 May 2019	0.2	0.2
7 May 2020	0.3	–
	<b>0.5</b>	0.4

The weighted average remaining contractual life of share options outstanding at 28 February 2021 was 0.5 years (2020: 0.36 years). The weighted average share price during the year for options exercised was 203 pence (2020: 209 pence).

### 39. Share-based payments continued

#### d. Bonus Share Award

The bonus arrangements for senior managers include corporate and personal performance targets. A profit gateway is in place which means that a certain level of underlying profit before tax must be achieved before any bonus related to the corporate element of the bonus is released.

60% of the bonus is paid in cash and 40% awarded in shares. They are automatically released after three financial years. Shares are subject to forfeiture if the participant resigns or is dismissed.

Dividends accrue on these shares and are released at the end of the three-year retention period.

A reconciliation of the number of shares granted over the year is shown below:

	2021 Million	2020 Million
Outstanding at beginning of year	1.1	1.1
Granted	0.6	0.6
Exercised	(0.4)	(0.4)
Lapsed	(0.2)	(0.2)
Outstanding at end of year	1.1	1.1

The number of shares conditionally allocated at the end of the year is set out below:

	2021 Million	2020 Million
11 May 2017	–	0.4
11 May 2018	0.2	0.3
9 May 2019	0.4	0.4
7 May 2020	0.5	–
	1.1	1.1

The weighted average remaining contractual life of share options outstanding at 28 February 2021 was 1.3 years (2020: 1.5 years). The weighted average share price during the year for options exercised was 187 pence (2020: 223 pence).

### 40. Related party transactions

#### a) Transactions with related entities

##### J Sainsbury plc

The Bank is a wholly owned subsidiary of J Sainsbury plc.

	2021 £m	2020 £m
<b>Transactions during the year</b>		
<i>Services and loans provided by J Sainsbury plc:</i>		
Management services	13	24
Share capital issued to J Sainsbury plc	–	35
<i>Services and loans provided to J Sainsbury plc:</i>		
Management services	5	–
<b>Balances at end of year</b>		
<i>Payables:</i>		
Management services	4	3

Included within management services provided by J Sainsbury plc are amounts recharged to the Bank for Nectar points. Services and loans provided to J Sainsbury plc comprises Travel Money staff being redeployed to J Sainsbury plc store working due to the COVID-19 pandemic.

## 40. Related party transactions continued

### Lochside Asset Purchaser No.1 plc

The Bank's personal loans securitisation programme issued via Lochside Asset Purchaser No.1 plc was fully redeemed on 27 May 2020 resulting in full repayment of the Senior class A note, Junior/Subordinated class B note and Reserve note.

	2021 £m	2020 £m
<b>Transactions during the year</b>		
<i>Interest paid on 'failed sale' liability</i>	<b>(1)</b>	(4)
Servicer fee received	–	1
Redemption of Senior 'A Notes'	<b>(101)</b>	(174)
Repayment of intercompany loan	<b>(6)</b>	–
<b>Balances at end of year</b>		
<i>Other assets:</i>		
Intercompany loan	–	6
<i>Payables:</i>		
'Failed sale' liability	–	101
Book value of personal loans for which beneficial interest has transferred to SPV	–	182

For additional disclosure on the nature of the 'failed sale' liability see note 25.

### Drury Lane Funding 2020-1 plc

On 11 November 2020, the Bank securitised and sold a £725 million pool of personal loans to Drury Lane Funding 2020-1 plc, an SPV controlled by the Bank. The SPV issued a £500 million Senior class A note and a £225 million Junior/Subordinated class Z note to the Bank. The securitised pool of personal loan assets fails the derecognition requirements of IFRS 9 and so the Bank continues to recognise the personal loans on its balance sheet. As at 6 March 2021, the Bank had pledged £621 million of personal loans to the SPV.

The relevant personal loans continue to be serviced by the Bank and a servicer fee is receivable from the SPV as a result.

	2021 £m	2020 £m
<b>Transactions during the year</b>		
Interest paid	<b>(0.1)</b>	–
Issuance of liquidity reserve	<b>6</b>	–
<b>Balances at end of year</b>		
<i>Other assets:</i>		
Liquidity reserve	<b>6</b>	–
Intercompany asset	<b>25</b>	–
Book value of personal loans for which beneficial interest has transferred to SPV	<b>621</b>	–

The intercompany asset relates to cash collected on the securitised loans that has been paid across to the SPV. As the Bank retains the risk and rewards of the securitised loans and retains the notes issued by the SPV these cash payments are treated as an intercompany asset.

### Home Retail Group Card Services Limited

The Bank provides funding to Home Retail Group Card Services Limited via an intercompany loan.

	2021 £m	2020 £m
<b>Transactions during the year</b>		
<i>Services and loans provided by Sainsbury's Bank plc:</i>		
Interest receivable on intercompany loan	<b>16</b>	19
Management services	<b>1</b>	1
<b>Balances at end of year</b>		
<i>Other assets:</i>		
Intercompany loan	<b>453</b>	559

#### 40. Related party transactions continued

The loan to Home Retail Group Card Services Limited has no fixed repayment term but is repayable at the Bank's request. The loan operates as a revolving facility to fund the store card lending portfolio of Home Retail Group Card Services and the balance fluctuates in line with overall lending on that portfolio. Interest was payable three months in arrears at LIBOR plus a margin of 3% prior to transitioning to the Sterling Overnight Index Average (SONIA) rate from 8 February 2021. Interest remains payable three months in arrears, at SONIA plus a margin rate of 3.085%.

##### b) Transactions with key management personnel

For the purposes of IAS 24 'Related party disclosures', key management personnel comprise members of the Sainsbury's Bank plc Board and the Executive Committee of the Bank, who held office during the year.

##### Remuneration and other compensation

	2021 £m	2020 £m
Short-term employee benefits	3.9	4.2
Post-employment benefits	0.1	0.1
Termination benefits	–	0.4
Share-based payments	2.0	1.8
	<b>6.0</b>	<b>6.5</b>

Short-term employee benefits represent salary, bonus and benefits in kind. Post-employment benefits relate to employer's contributions to money purchase pension schemes operated by J Sainsbury plc. Share-based payments relates to share schemes operated by J Sainsbury plc (see note 39).

##### Product transactions

Details of transactions, under terms and conditions available to all colleagues, between the Bank and key management personnel are provided below. For this purpose, key management personnel include Sainsbury's Bank plc key management personnel and members of their close families.

	Number of key management personnel	Directors £000	Other £000
<b>Mortgages, credit cards and term loans</b>			
At 28 February 2019	5	7	–
Resignations during 2019/20	(3)	(6)	–
Appointments/New accounts during 2019/20	1	–	1
Amounts advanced during the year	–	11	28
Amounts repaid during the year	–	(10)	(27)
At 29 February 2020	<b>3</b>	<b>2</b>	<b>2</b>
Resignations during 2020/21	<b>(3)</b>	<b>(2)</b>	<b>(2)</b>
Appointments/New accounts during 2020/21	<b>3</b>	<b>2</b>	–
Amounts advanced during the year		<b>10</b>	<b>8</b>
Amounts repaid during the year		<b>(9)</b>	<b>(6)</b>
<b>At 28 February 2021</b>	<b>3</b>	<b>3</b>	<b>2</b>

#### 40. Related party transactions continued

	Number of key management personnel	Directors £000	Other £000
<b>Savings and deposit accounts</b>			
At 28 February 2019	6	482	–
Resignations during 2019/20	(4)	(362)	–
Appointments/New accounts during 2019/20	3	–	111
Amounts deposited during the year	–	–	37
Interest paid	–	1	1
Amounts withdrawn during the year	–	(112)	–
At 29 February 2020	<b>5</b>	<b>9</b>	<b>149</b>
Resignations during 2020/21	<b>(4)</b>	–	<b>(149)</b>
Appointments/New accounts during 2020/21	<b>1</b>	<b>12</b>	–
Amounts deposited during the year	–	<b>18</b>	–
Interest paid	–	–	–
Amounts withdrawn during the year	–	–	–
<b>At 28 February 2021</b>	<b>2</b>	<b>39</b>	–

Based on the Companies Act definition of Loans to Directors, total lending outstanding at 28 February 2021 was £nil (2020: £nil).

#### 41. Capital commitments

There are commitments in respect of capital expenditure which have been authorised, but not provided for in the financial statements, for which contracts have been entered into, on:

	2021 £m	2020 £m
Property, plant and equipment	<b>1</b>	2
Software development	<b>7</b>	5
	<b>8</b>	7

#### 42. Post balance sheet events

On 23 March 2021 the High Court Of Justice (Business and Property Courts of England and Wales Companies Court) approved a reduction of the ordinary share capital of the Bank from £900,750,000 to £700,750,172.25, having previously been resolved on and effected by a Special Resolution passed at a General Meeting of the Bank held on 23 February 2021.

The reduction became effective on 1 April 2021 upon registration of the court order with Companies House and resulted in an equal and opposite increase to retained earnings.

## Alternative performance measures

In the reporting of financial information, the Directors use various alternative performance measures (APMs) which they believe provide additional useful information for understanding the financial performance and financial health of the Bank. These APMs should be considered in addition to, and are not intended to substitute IFRS measurements. As they are not defined by International Financial Reporting Standards, they may not be directly comparable with other companies who use similar measures. All of the following APMs relate to the current period's results and comparative periods where provided.

The Bank also discloses a number of capital and liquidity metrics relevant to its financial position which are required under prudential rules issued by the PRA and FCA. The bases of calculation of those metrics is defined within the relevant legislation and are disclosed in the Glossary.

APM	Definition/Purpose	Reconciliation			
<b>Underlying profit before tax</b>	Profit of loss before tax before any items recognised which, by virtue of their size and/or nature, do not reflect the Bank's underlying performance	A reconciliation of underlying profit before tax is provided in note 8 of the financial statements			
<b>Net Interest Margin (NIM)</b>	Net interest income as a percentage of average interest-earning assets		<b>Ref</b>	<b>2021</b>	<b>2020</b>
		Interest Income	IS	241	304
		Interest expense	IS	(81)	(115)
		Underlying Net Interest Income		160	189
		Monthly average interest earning assets <sup>1</sup>		6,715	7,695
		Underlying NIM		2.4%	2.5%
		1 Monthly average interest earning assets is not presented in the financial statements. The closing balance at Feb-21 is £6,059 million (2020: £7,659 million); (made up of £4,598 million (2020: £6,511 million) Loans and advances to customers, £587 million (2020: £853 million) investment securities, and £874 million (2020: £294 million) of interest bearing deposits within cash held with central banks).			
<b>Bad Debt Asset Ratio (BDAR)</b>	Impairment losses as a percentage of the average net balance of loans and advances to customers		<b>Ref</b>	<b>2021</b>	<b>2020</b>
		Impairment losses	IS	58	48
		Monthly average customer lending <sup>1</sup>		5,476	6,508
		BDAR		1.1%	0.7%
		1 Monthly average customer lending is not presented in the financial statements. The closing balance at Feb-21 is £4,598 million (2020: £6,511 million)			
<b>Cost: Income Ratio</b>	Underlying operating expenses as a percentage of total income		<b>Ref</b>	<b>2021</b>	<b>2020</b>
		Operating expenses	IS	326	268
		Non-underlying items	Note 8	(126)	(25)
		Underlying expenses		200	243
		Total Income	IS	221	323
		Cost: Income ratio		90%	75%
<b>Return on capital employed</b>	Underlying profit after tax divided by average equity		<b>Ref</b>	<b>2021</b>	<b>2020</b>
		Underlying profit/(loss) before tax	IS	(36)	33
		Notional tax charge		–	(6)
		Underlying profit/(loss) after tax		(36)	27
		Monthly average equity <sup>1</sup>		903	980
		Return on tangible equity		(3.9)%	2.7%
		1 Monthly average equity is not presented in the financial statements. The closing balance at Feb-21 is £849 million (2020: £1,000 million).			

## Glossary

**Bad debt asset ratio** – Impairment losses as a percentage of the average net balance of loans and advances to customers.

**Tier 1 capital** – A measure of the Bank's financial strength as defined by the PRA. It captures Common Equity Tier 1 capital plus other Tier 1 securities in issue, but is subject to a deduction in respect of material holdings in financial companies.

**Common Equity Tier 1 capital ratio** – Tier 1 capital as a percentage of risk-weighted assets.

**Cost: income ratio (underlying)** – Underlying operating expenses as a percentage of total income.

**Debt securities** – Assets held by the Bank representing certificates of indebtedness of credit institutions, public bodies or other undertakings, excluding those issued by Central Banks.

**Earnings at risk** – Approach set out for the quantification of interest rate risk expressed as the impact of the sensitivity analysis on the change to net interest income.

**Effective interest rate** – The effective interest rate method calculates the amortised cost of a financial asset or financial liability, and allocates the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset or financial liability.

**Encumbered asset** – An asset is defined as encumbered if it has been pledged as collateral against an existing or off-balance sheet liability and therefore is no longer available for disposal or as collateral to support liquidity or funding requirements of the Bank.

**Fair value** – The amount for which an asset could be exchanged, or a liability settled, between willing parties in an arm's length transaction.

**Financial Services Compensation Scheme (FSCS)** – The UK's independent statutory compensation fund for customers of authorised financial services firms which pays compensation if a firm is unable to pay claims against it. The FSCS is funded by management expenses levies and, where necessary, compensation levies on authorised firms.

**Full time equivalent** – The hours worked by part time employees are accumulated along with the number of full time employees and counted as full time equivalents. This is a more consistent measure of the amount of time worked than employee numbers which will fluctuate as the mix of part time and full time employees changes.

**Funding for Lending Scheme (FLS)** – A Bank of England run scheme designed to encourage banks to increase lending to businesses by lowering interest rates and increasing access to credit. This was facilitated by BoE lending to the banks at cheaper than market rates for up to four years.

**Impaired loans** – Impaired loans are loans for which all the full contractual cash flows are no longer expected to be collected or collection of such cash flows will not be as they are contractually due.

**Impairment losses** – An impairment loss is the reduction in value that arises after the impairment review of an asset that determines that the asset's value is lower than its carrying value.

**Interest rate risk** – The risk of a reduction in the value of earnings or assets resulting from an adverse movement in interest rates.

**Loans past due** – These are loans for which a customer has failed to make payment as and when they are contractually due.

**Leverage ratio** – CET1 capital divided by the exposure measure. This is a new balance sheet metric introduced by the PRA.

**Liquidity Coverage Ratio (LCR)** – Percentage of the stock of highly liquid assets such as cash to net cash outflow over a 30 day period.

**Loans to deposits ratio** – The ratio of loans and advances to customers net of allowance for impairment losses divided by customer deposits.

**Master netting agreement** – An agreement between two counterparties that have multiple derivative contracts with each other that provides for the net settlement of all contracts through a single payment, in a single currency, in the event of default on, or termination of, any one contract.

**Net interest margin** – Net interest margin is net interest income as a percentage of average interest-earning assets.

**Net stable funding ratio** – Amount of available stable funding (ASF) relative to the amount of required stable funding (RSF) over a one-year time horizon, assuming a stressed scenario.

**Pillar 3** – The third pillar of the Basel III framework which aims to encourage market discipline by setting out disclosure requirements for banks on their capital, risk exposures and risk assessment processes. These disclosures are aimed at improving the information made available to the market.

**Repurchase agreements** – An agreement where one party, the seller, sells a financial asset to another party, the buyer, at the same time the seller agrees to reacquire and the buyer to resell the asset at a later date. From the seller's perspective such agreements are repurchase agreements (repos) and they are reverse repurchase agreements (reverse repos) from the buyer's perspective.

**Return on capital employed** – Underlying profit after tax divided by average equity.

**Securitisation** – This is a process by which a group of assets, usually loans, are aggregated into a pool, which is used to back the issuance of new securities.