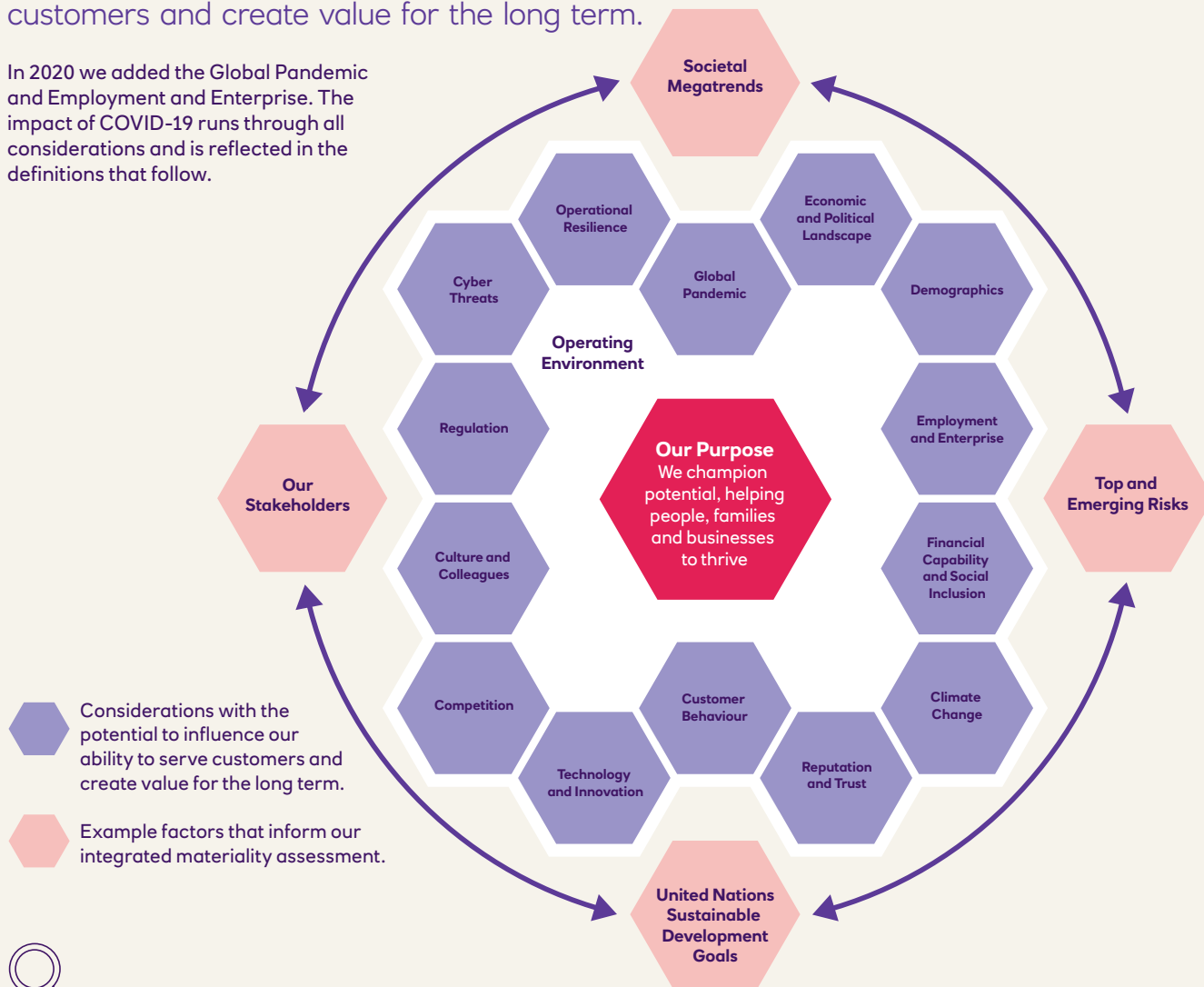


Our operating environment.

This illustration of our operating environment provides an integrated materiality assessment of the most important considerations with the potential to influence our ability to serve customers and create value for the long term.

In 2020 we added the Global Pandemic and Employment and Enterprise. The impact of COVID-19 runs through all considerations and is reflected in the definitions that follow.



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Global Pandemic

COVID-19 has had global ramifications on health, economies, societies and the environment. The pandemic has put Our Purpose-led strategy into action, as we supported individuals, families and businesses to deal with the immediate and longer-term impacts. We responded quickly to the elevated credit risks via active portfolio management including adjustment of risk appetite, proactive customer contact strategies and scenario analysis. Our participation in government initiatives supported customers during the crisis and included the Bounce Back Loan Scheme which could increase conduct, reputational and fraud risks. High uncertainty remains on the ultimate impact of the pandemic and across the economic landscape, and strategy is being adapted in response. ‘Build Back Better’ became the call from the UN and we support a focus on opportunities unlocked by the transition to a low carbon economy, progress on racial inequality, helping communities to thrive, as well as greater alignment with UN Sustainable Development Goals.

Economic and Political Landscape

The economic environment in 2020 became and remains unusually uncertain as the COVID-19 crisis delivered an unprecedented shock to the UK and global economy. Support schemes for furloughed workers and government backed loans for businesses supported the economy as priorities were placed on public health, capacity of the NHS, and social distancing restrictions until the roll out of a vaccine. Significant risks remain regarding the extent of the economic contraction and weaker than expected recovery from COVID-19, elevated geopolitical risks and developments in relation to a Scottish independence referendum. In the longer term, demographic change, high levels of debt and inequality could all have financial impacts. As a result, we closely monitor these risks with strategic plans adapted as appropriate.

Demographics

Demographic shifts mean that the needs and behaviours of our customers are changing. In 2020 this was amplified by lockdowns and social distancing leading to some customer segments adopting new technologies for the first time. Key trends continue to impact our customers including retiring later and working longer, renting for longer or buying a house later in life and often with the support of family members and more focus on financial planning for retirement. We are committed to supporting the evolving needs of customers ranging from home ownership to digital banking and supporting customers at every stage of their lives.

Employment and Enterprise

Unemployment rose to its highest level since 2016 during 2020. Government support schemes were successful in limiting a more material impact on the labour market, while government-backed lending schemes provided liquidity across the SME and corporate sectors. We are the biggest supporter of UK businesses and Enterprise is one of our three areas of focus. We acted to support businesses throughout COVID-19 and continued to address barriers for start-ups in underrepresented groups including supporting female entrepreneurship, Black, Asian and Minority Ethnic businesses, areas outside of London and socially purposeful businesses in the drive toward a low carbon economy.

Financial Capability and Social Inclusion

Supporting financial capability and confidence sits within our three areas of focus. It goes beyond delivering fair products and great service. It means helping customers, wider society and future generations to develop good money management skills so they are empowered to make better financial decisions. Customers are supported by a diverse range of tailored banking services and products. In 2020 we increased focus on supporting customers facing financial difficulty, or in vulnerable situations, and helping more people to start saving.

Climate Change

We expect to face significant risks in connection with climate change and the transition to a low carbon economy. These risks are subject to rapidly increasing prudential and regulatory, political and societal focus, both in the UK and internationally. We have set an ambition to be a leading

bank in the UK and RoI helping to address the climate challenge. Through engagement with key stakeholders, we are working to champion climate solutions and accelerate the speed of transition in line with the 2015 Paris Agreement. In 2020 we became a sponsor of COP26.

Reputation and Trust

Restoring trust and safeguarding reputation remains a key priority for most banks. We strive to build a reputation as a purpose-led bank: championing potential, helping people, families and businesses to thrive. As a relationship bank for an increasingly digital world, our strategic priorities are to be simple to deal with, supporting customers at every stage, powered by innovation and partnerships and sharpened capital allocation. Customer NPS and stakeholder engagement and advocacy act as measures of satisfaction, reputation and trust.

Customer Behaviour

Customers' needs and behaviours are changing as a result of new technologies, demographic shifts and changing labour patterns. The impact of COVID-19 accelerated trends toward digital technology, changed ways of working, shopping, socialising and communication and how people use the physical spaces. We understand the importance of supporting customers' needs, being simple to deal with and supporting customers at every stage of their lives to tailor banking services and products that meet their evolving needs and expectations.

Technology and Innovation

Customer behaviours continue to change, and new business models emerge, through advancing technology. COVID-19 has increased our customers' reliance on technology with a further shift to digital, reinforcing the need for modern capabilities and resilient systems. Our active digital users across both personal and business customers continued to grow in 2020 and we invested £581 million on technology. Our focus is to reduce year on year cost by simplifying processes, improving our resilience and stability whilst helping to deliver innovative solutions for our customers.

Competition

We operate in markets that are highly competitive raising the threat of a sustained loss of business volumes or sustained margin pressure related to changes in regulation, developments in financial technology (including digital money and competition from digital niche competitors) and major shifts in customer behaviour. We closely monitor the competitive environment and adapt strategy as appropriate to deliver innovative and compelling propositions for customers. The roll out of Tyl and the launch of Payit were significant milestones in the evolution of our competitive offering.

Culture and Colleagues

Building and nurturing a healthy culture where colleagues are engaged, and where our working environment is underpinned by robust risk behaviours, is critical to delivering on our purpose and strategy. In 2020 we supported colleagues as they transitioned to new ways of working, focusing on wellbeing while continuing to build an

inclusive bank which is a great place for all colleagues to work. Becoming a learning organisation sits within one of our three areas of focus as we prepare colleagues for the future and embed Our Purpose.

Regulation

We operate in a highly regulated market which continues to evolve in scope. Areas of regulatory focus include customers in vulnerable situations, climate change, financial crime, capital and liquidity management, use of models and the transition to alternative risk-free rates. We monitor regulatory change, implement new regulatory requirements where applicable and have regular engagement meetings with regulators to discuss key regulatory priorities.

Cyber Threats

We experience a constant threat from cyber-attacks both directly and to our supply chain, re-enforcing the importance of due diligence with the third parties on which we rely. We continue to invest significant resources in the development and evolution of cyber security controls and work to protect and educate our customers on fraud and scam activity.

Operational Resilience

To provide continuity of service for customers with minimal disruption, we continue to monitor and assess a diverse and evolving array of threats, both external and internal, as well as developing, strengthening or adapting existing control capability to be able to absorb and adapt to such disruptions.