Leeds Building Society

Annual Report & Accounts 2017

Leeds Building Society

A Perfect Partnership

2017: a year in review

Gross residential lending exceeded
£4.1bn
(2016: £4bn)

We helped **50,279** people have the home they want.

We paid an average of
1.33%
to our savers compared to the rest of market average of 0.70%

An annual benefit to all our savers of **£75m**.

Record savings balances up 17% to
£13.1bn
(2016: £11.2bn)

We helped **71,429** people save for their future.

Total assets up 16% to
£18.5bn
(2016: £15.9bn)

Profit before tax up 4% to
£120.9m
(2016: £116.6m)

Common Equity Tier 1 Capital is
14.5%
(2016: 15.2%)

Reserves available to protect us from future problems.

Customer satisfaction
91%
(2016: 92%)

We have an ongoing commitment to be customer focused in everything we do.

Leeds Building Society

Colleague engagement score up 2% to
80%
(2016: 78%)

We're committed to being a great place to work.

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Year ended
31 December 2017

I'm pleased to report that Leeds Building Society had a successful year in 2017. During a period of uncertainty around the UK's future relationship with Europe and a snap General Election, we have delivered another strong set of results and continued to help people save and have the home they want.

Assets increased by 16%, to £18.5 billion, and membership is now more than 796,000. Our lending growth, combined with reduced losses from historical loans, led to a record level of profit, enabling us to increase our capital and invest further in the long term future of the Society.

Economic background

The UK economy continued to show signs of resilience last year although the rate of growth slowed in 2017,[1] as uncertainty remains, ahead of the UK's exit from the EU. Globally, however, the outlook broadly strengthened.

The US Federal Reserve has gradually increased interest rates, citing strong prospects for economic growth and rising employment. Within the Eurozone, activity also picked up and the European Central Bank announced it will begin to scale back its financial stimulus programme this year.

UK unemployment was 4.4% in the three months to December[2]. However, CPI inflation reached 3.1%[3] and is expected to remain above the Bank of England's 2% target until 2020[4], which will put pressure on disposable income over the medium term.

In November the Bank of England responded to positive economic data by reversing the cut made to Bank Base Rate in the wake of the vote to leave the EU, raising it back to 0.50%.

Competition in the mortgage market intensified, which resulted in further reductions to average new mortgage rates during 2017[5]. This has been good news for borrowers as the cost of servicing mortgage debt for households is now lower than at any time since the early 1990s[6].

Gross mortgage lending in the UK reached £257 billion[7], up 4% year on year, and while the pace of house price inflation slowed in 2017, it remained positive. The Halifax House Price Index grew 2.7% in the year to December, compared to 6.5% a year earlier[8].

Market rates paid to savers also fell in 2017 but we continued to support our savings members, paying on average 0.63%[9] more to savers than our competitors.

Regulation and industry developments

In December 2017, the Basel Committee published the final requirements for the next phase of prudential regulation, setting out a number of further refinements to global capital and liquidity requirements. We will continue to prepare for the changes, which we expect to be implemented over the next few years.

Earlier this year, the revised Payment Services Directive came into effect to enhance protection for customers and promote a level playing field for payment service providers. Where applicable, we have taken the necessary steps to meet the new rules.

Over the coming years, the impact of leaving the EU will become clearer. However, we do not expect any significant UK regulatory changes as the Government negotiates exit terms. We will continue to monitor any developments and how these may affect the Society or members.

The Financial Conduct Authority (FCA) is carrying out an in-depth mortgage market study, to assess customers' abilities to make effective decisions on the right products and services for them. The outcome of the review is expected in spring this year.

The General Data Protection Regulation comes into force in May. This will strengthen the data protection framework across the EU and provide consumers with greater control over their personal data. We are preparing for these changes and taking the necessary steps to comply with the new rules.

As part of the EU's Bank Recovery and Resolution Directive, the final framework and policies for setting Minimum Requirement for Own Funds and Eligible Liabilities (MREL) have been published by the Bank of England. This will require relevant banks and building societies to hold additional loss absorbing capital and this has been factored into our future plans, to ensure we are well positioned to meet the requirements.

Summary

During 2018, we anticipate that competition in the mortgage market will intensify and uncertainty around leaving the EU will continue.

Nonetheless, our strong performance over many years means that we expect to continue to grow in a measured way and invest in the long term future of the Society for the benefit of all our members.

Our Society would not be successful without our dedicated colleagues who work so hard to deliver excellent service. On behalf of the Board, I would like to thank them and you, our members, for choosing Leeds Building Society.

Robin Ashton
Chairman

27 February 2018

1. Source: Office for National Statistics – GDP in 2017 was 1.8% (vs. 1.9% in 2016)
2. Source: Office for National Statistics – ILO Unemployment rate October-December 2017
3. Source: Bank of England – CPI inflation, November 2017
4. Source: Bank of England – December 2017 Inflation Report inflation projections
5. Source: Bank of England – Average effective interest rates on new individual mortgages
6. Source: Bank of England – Aggregate household debt-servicing ratio – defined as interest payments plus regular mortgage principal repayments as a share of household disposable income
7. Source: UK Finance – Gross mortgage lending estimate for the 12 months up to December 2017
8. Source: Halifax HPI, Annual change as at December 2017
9. Source: CACI CSDB, Stock, January 2017 – December 2017, latest data available. CACI is an independent company that provides financial services benchmarking data and covers 86% of the high street cash savings market

Chief Executive Officer's Highlights

Year ended
31 December 2017

I'm delighted to report that we've once again delivered on our mission to help people save and have the home they want. Savings and mortgage balances, membership numbers and assets are all at record levels as we continue to grow sustainably and invest for the long term benefit of the Society.

Supporting the aspirations of savers and borrowers

As a member owned building society, we work hard to balance the needs of both savers and borrowers, and during 2017 we took a number of actions to deliver this.

In October last year, we increased the current minimum rate we pay all our saving members[1] to 0.50%. This was at a time when many of our competitors were cutting rates and prior to the Bank of England increasing Base Rate for the first time in over a decade. We were also the only high street financial services provider to pay this minimum rate across both ISAs and non-ISAs.

As a result, we paid an average 1.33% to our savers compared to the rest of market average of 0.70%[2], which equates to an annual benefit to our savers of £75 million. Our support for savers was recognised with the 'Best Building Society Savings Provider' award for the second year running from the independent comparison site, Moneyfacts.

Competition in the mortgage market meant average new mortgage rates reduced during 2017. Our excellent savings performance enabled us to keep growing our mortgage lending and focus on mainstream borrowers as well as those who are not well served by the wider market.

We increased our mortgage market share for the seventh consecutive year and lent more than £4.1 billion across a balanced product range, an increase of 3% compared to a year earlier. We supported key segments such as Shared Ownership, Affordable Housing, Help to Buy and Interest Only, and helped a record 13,000 people buy their first home.

Our consistent approach to supporting borrowers who are less well served by the wider market helped us achieve the accolade of 'Best Shared Ownership Lender' for the second consecutive year from What Mortgage magazine.

Redemptions increased compared to 2016 but our strong performance in gross lending helped deliver 14% growth in residential mortgage balances.

Continuing financial security

Our successful mortgage strategy and improvements made to our underwriting processes have supported sustained lending growth over the past few years which, combined with a further reduction in loss charges, helped us achieve a profit before tax of £120.9 million.

The resilient UK economy and high levels of employment resulted in residential arrears[3] reducing to 0.7% in 2017, which means that fewer than one in every 140 borrowers are experiencing difficulty paying their mortgage. We also continued to manage down our commercial lending portfolio and these loans now represent less than 0.5% of all loans to customers.

A good level of profit is essential to the success of a building society and our profit in 2017 enabled us to increase our capital to £988 million, well above the regulatory minimum requirements.

We have been notified of our indicative Minimum Requirement for Own Funds and Eligible Liabilities (MREL), which will be phased in on a transitional basis from 2020. We intend to meet our MREL ahead of the regulatory timeframe.

Uncertainty surrounding the UK's exit from the EU remains. We also encountered high levels of competition last year, which we anticipate will continue. This is likely to put some downward pressure on our net interest margin as we move through 2018 and into 2019.

However, our robust performance means we're well placed to withstand economic uncertainty, protect our members' money and keep growing sustainably.

Delivering outstanding personal service

We've made purposeful progress in improving the experience we provide. By working in partnership with our members and brokers, who introduce the majority of our mortgage business, we've seen strong savings and lending growth and high satisfaction scores in 2017.

We delivered a number of service enhancements including a new automated eISA process, which cut the average time to transfer tax-free funds into the Society to only three days. This improved customer experience, removed the use of cheques and meant our members earned interest with the Society sooner, and faster than the industry average[4].

We also improved our online lending affordability and monthly repayment calculators, and launched a new online switching service making it easier for existing borrowers to take a new product with the Society. Our focus on making things simpler has further reduced the amount of time it takes between mortgage application and offer, which means we're helping borrowers into the home they want sooner.

Our online members' forum, TalkingPoint, now has more than 2,700 actively engaged members, who help us make better informed decisions in the long term best interests of current and future members.

Once again, my colleagues delivered excellent service throughout the year and we received the 'Best Building Society – Customer Service' award at the 20th Annual Personal Finance Awards. I'd like to thank them for their skill and dedication, which has been key to our success in 2017.

Investing in the Society

Branches continue to play an important role in attracting the retail savings that enable us to grow mortgage lending.

We completed a cost-effective refurbishment of all our branches, creating a more modern environment for members and reducing our impact on the environment through energy-efficient technology. This, combined with purchasing renewable electricity, was instrumental in the Society achieving the Carbon Trust Standard for Carbon for our ongoing commitment to reducing the carbon footprint of our operations.

1. As long as the account is operated in line with the Terms and Conditions
2. CACI CSDB, Stock, January 2017 – December 2017, latest data available. CACI is an independent company that provides financial services benchmarking data and covers 86% of the high street cash savings market
3. 1.5% or more of outstanding mortgage balances
4. Source – Cash ISA Transfer Service – BACS Cash ISA Participation Performance Report

Chief Executive Officer's Highlights

Year ended
31 December 2017

Continued

We've also reviewed our network to ensure branches are in areas where there is sufficient demand for a face-to-face service. As a result of detailed research and feedback, we relocated our London branch and successfully opened a new branch in Bournemouth. We'll continue to consider other new sites where appropriate.

However, in line with other banks and building societies, our members are increasingly using multiple branches, telephone and the internet to access our products and services. Use of some locations had declined to an extent they were no longer sustainable and we took the difficult decision to close a small number of branches.

Our focused growth and the number of new jobs we've created over the past five years has meant we've outgrown our Head Office building in Leeds, and we currently operate over three sites in the city centre. We've now secured an office building that keeps us in the heart of Leeds, provides sufficient accommodation for our Leeds-based colleagues and is close to existing transport links. This will make us even more efficient, reduce the costs associated with operating over multiple sites, and limit our impact on the environment.

We're also continuing to invest in flexible and resilient technology as we strive to meet the changing needs of our members, and further develop our digital and online capability.

Our focus on efficiency enabled us to deliver this investment and control costs, which grew by 4% in line with profit before tax. Our cost to income ratio remained flat, at 43%, and we reduced our cost to mean asset ratio to 0.56%, from 0.62% in 2016.

We'll continue to balance the need to invest in the Society while maintaining a sustainable, low cost base and we expect these ratios to remain among the best in the building society sector.

This year, I'm also pleased to report we've made excellent progress against our Corporate Responsibility targets, which were first published in December 2016, and we will continue to focus on doing the right thing. Over 50% of our colleagues volunteered in the community and I commend them for their efforts.

I'm also very proud that we're partnering with parkrun, a not-for-profit organisation providing over 650 free weekly running events in communities throughout the UK, and Samaritans, as we aim to raise £250,000 over the next two years to support those who are struggling to cope.

Outlook

Our performance in 2017 provides clear evidence of how Leeds Building Society continues to deliver on its mission to help people save and have the home they want. Central to this success is our commitment to doing the right thing for our members, colleagues and communities.

Our strong profit has resulted in record retained capital and reserves and further consolidated our financial strength.

Looking forward, we will continue to monitor the implications of the UK's exit from the EU. We expect competition in our core markets will remain high but our focus on efficiency and growth will offset some of the impact of the downward pressure on margin.

We remain committed to delivering our strategy of investing in the long term interests of the Society and sustainable growth for the benefit of you, our members, and I would like to thank you for your continued support in 2017.

Peter Hill
Chief Executive Officer

27 February 2018

We've once again delivered on our mission to help people save and have the home they want. Savings and mortgage balances, membership numbers and assets are all at record levels as we continue to grow sustainably and invest for the long term benefit of the Society.

Business Model

Year ended
31 December 2017

Leeds Building Society is the fifth largest building society in the UK, with assets of £18.5 billion. As a member owned mutual, the Society's mission is to help people save and have the home they want. This is delivered using a straightforward business model:

The Society borrows from savers via:
Branch
Online
Post

Building societies fund the majority of mortgage lending with members' savings. The Society offers products through a network of 55 branches, by phone, post and online.

The Society aims to increase the recognition of its brand and reach to younger demographics.

A range of competitive products is offered to over half a million saving members which provide long term value when compared to the wider savings market.

As well as:
Raising long term, stable and diverse funds from the wholesale markets.

The balance of funding required for lending and maintaining an appropriate level of liquidity is obtained from the wholesale money markets. The amount of wholesale funding the Society receives varies on a daily basis and is typically managed to around a fifth of total funding.

The Society has a long term 'A'[1] credit rating. This allows the Society to access wholesale funds on competitive terms and across a number of instruments and durations.

And lends to mortgage borrowers:
Mainstream residential
First time buyers
Shared ownership
Buy to let

The Society provides mortgages secured on residential property in the UK, including for shared ownership and buy to let purposes.

Mortgage business is sourced through a network of approved mortgage brokers, as well as via online and direct telephone services.

The Society has total residential mortgage assets of £14.9 billion. A prudent approach to credit risk is reflected in the overall weighted indexed loan to value on the mortgage portfolio being 56%.

Lending across a number of segments allows the Society to manage credit risk across the whole mortgage portfolio whilst achieving appropriate margins.

The Society's approach to business delivers member value

- A strong capital base is maintained to ensure long term security for members. A prudent approach to lending and strong profitability helps ensure the Society can meet the necessary capital requirements.
- Competitive products are offered with savings rates that remain higher than the market average.
- The highest standards of trust and integrity are observed in all engagement with members. This, along with competitive products and investment in the Society, helps build member satisfaction and strong long term relationships.
- Families and first time buyers are helped to purchase homes through competitive products. A focus on customer needs means the Society can lend to borrowers in smaller segments which are typically less well served by other banks and building societies (but not expose itself to too much risk).
- High levels of customer service are maintained and the customer is at the centre of the Society's operational processes with a single contact point provided where possible.

1. Moody's A3; Fitch A-

Remaining financially stable by:
Maintaining liquid investments with strong credit rated institutions and central banks.

The Society maintains a portfolio of liquid investments, used to ensure there is sufficient cash available to meet the requirements of savers, investors and other creditors.

Assets are invested conservatively, in a range of high quality investment instruments, with a spread of counterparties.

The Society also retains access to contingent liquidity facilities to help ensure sufficient liquidity is held at all times in excess of regulatory requirements.

Investing to:
Continually improve the products and services we offer to help existing members and attract new ones.

The Society is investing in its digital capability so that savers can access products more easily and manage savings through the internet and mobile devices, as well as through traditional channels. The mortgage application process is being streamlined for brokers and customers.

A strong focus on customer experience and digital channels will help the Society attract new saving and mortgage members.

And is financially secure:
Making sufficient profit to maintain a strong capital base.

The Society aims to generate sufficient profit to maintain a strong capital position, so it can continue to grow, invest and enhance its customer proposition.

This requires a strong focus on cost efficiency and management of the net interest margin meaning the Society can price competitively to provide value to existing members, while attracting new borrowers and savers.

Society values

Society values explain the behaviours all colleagues are expected to display in everything they do, underpinning the delivery of the Society's business model and strategy. They are as follows:

Collaborative – nurturing positive relationships

Progressive – always moving forward

Passionate – determined to succeed

Straightforward – doing the right thing

Integrity – trusted custodians

Responsible – taking personal ownership

Business Model

Year ended
31 December 2017

Continued

Strategic priorities

The Society has a vision to become Britain's most successful building society and focuses on four strategic pillars. 2017 has been a year of very good progress, the key areas are highlighted below.

Strategic pillars	How this is delivered	Progress in 2017
Customer focused To support the aspirations of a wide range of borrowers and savers, in particular those who are not well served by the wider market.	The Society has been a mutual organisation for over 140 years, which means customers are also members. The Society does not have the distraction of separate shareholders and is able to have a customer centric focus on everything it does. Competitive products are developed which meet customer needs. The Society's flexible systems and risk management capabilities are used to meet customer needs in areas which have historically been underserved, while competitive savings products offer members long term value.	• Savings rates in the market reduced further in 2017, yet the Society continued to offer a compelling product proposition and was able to pay higher savings rates than the market average. The Society has also been able to retain significant maturing balances, helping to grow savings balances to a record level. • Gross mortgage lending was a record £4.1 billion and was above the Society's natural market share[1]. • Significantly improved the online account opening process for new accounts. The Society continues to work on enhancing its digital proposition for both members and brokers.
Secure To generate strong levels of profit which are retained in the business to build a solid platform for growth.	The Society is well capitalised and retains capital and leverage ratios in excess of the regulatory minima. This provides the Society with the resources to grow mortgage lending, invest and meet future regulatory changes, whilst maintaining a secure Society for members. Risks are managed through investing in resources and technology. The Society continues to develop Internal Ratings Based (IRB) capabilities for the assessment and management of credit risk for residential mortgages. Legacy portfolios are proactively managed to reduce the credit risk associated with these loans.	• A strong profit performance has provided capital to grow. The Society's Common Equity Tier 1 and leverage ratios remained well above regulatory requirements. The Society's future capital plans incorporate its expected MREL requirements. • A number of projects have been completed to ensure the Society continues to comply with its regulatory obligations. The changes implemented include Payment Services Directive 2 and International Financial Reporting Standard 9. Further changes for General Data Protection Regulation and cheque imaging are being progressed. • The Society continues to progress its application to manage credit risk on an IRB basis with the Prudential Regulation Authority.
Service driven To deliver outstanding personal service to all members.	Strong relationships exist with the Society's approved network of mortgage brokers. The Society is increasing the number of brokers under active management via a dedicated Business Development Manager. Customer centric processes are being developed, supported by flexible systems, so that members can engage with the Society across their chosen method of communication: web, email, smartphone, telephone or mail. Outstanding personal service is delivered by highly engaged colleagues across the Society.	• Colleague engagement and leadership scores improved again during the year and continue to be in the top quartile for the financial services industry. The Society retained its one star award in the Best Companies survey. • Continued to reduce the average time it takes to issue a mortgage offer, without any relaxation in underwriting standards. • The time to process ISA transfers has been cut from 15 days to three. This means customers start earning interest with the Society sooner.
Efficient To continue to reinvest in the business to improve efficiency, whilst being intolerant of waste.	The Society maintains a resilient and scalable core administration system platform on which future developments can be made. Over recent years ,the investment programme has increased capacity and capability across the Society. This enables growth, while meeting the requirements associated with a highly regulated business.	• The Society has continued to review its target operating model to ensure its operations remain appropriate for the future. • A new programme, "Project Me", was launched to add to the personal and career development support offered to colleagues. This is expected to help retain and reward the best talent. • A new building has been acquired as a Head Office. This will reduce the current three Leeds city centre locations to a single site, with resultant long term cost savings. • Completed a review of the branch network to ensure it remains relevant and in appropriate locations to meet the ever-changing needs of members. As a result, in the first half of the year, eight branches, which were under-used and in close proximity to other branches, closed and the London branch was relocated. A new branch has also been opened in Bournemouth.

Key Performance Indicators

The Society measures its performance against a number of key performance indicators, shown below.

Customer focused

Key performance indicator	What is measured	Performance	2017 update
New (gross) residential lending	The value of residential lending advanced by the Society during the year, including loans for house purchases, further advances and remortgages.	**2017** £4.1bn **2016** £4.0bn **2015** £3.1bn **2014** £2.7bn **2013** £2.2bn	The Society's strong product proposition and focus on key segments led to record gross lending of £4.1 billion. Gross lending was significantly above the Society's market share[1].
Net residential lending	Gross residential lending, less repayments of principal and redemptions. This represents the change in residential mortgage balances outstanding.	**2017** £1.8bn **2016** £1.9bn **2015** £1.4bn **2014** £1.1bn **2013** £1.0bn	Redemptions increased compared to 2016 but a strong performance in gross lending helped deliver 14% growth in residential mortgage balances.
Savings balances	The value of shares and deposits held by the Society's members and other customers.	**2017** £13.1bn **2016** £11.2bn **2015** £9.9bn **2014** £9.2bn **2013** £8.6bn	The Society's compelling range of savings products drove record savings growth of £1.9 billion to £13.1 billion.
Society membership	The number of Society members. Increasing the number of members is part of achieving the Society's vision.	**2017** 796,000 **2016** 756,000 **2015** 719,000 **2014** 697,000 **2013** 690,000	The strong performance on new lending and the increase on savings balances resulted in membership rising to a record 796,000.

Secure

Key performance indicator	What is measured	Performance	2017 update
Profit before tax	Profit before tax, creating capital to support future business growth.	**2017** £120.9m **2016** £116.6m **2015** £108.5m **2014** £80.9m **2013** £64.2m	Balance sheet growth and impairment releases on loans to customers have driven a record level of profit before tax.

1 Leeds Building Society defines market share as follows:
Mortgages – Market share statistics published by UK Finance
Savings – Mutual sector net retail savings as published by the Building Societies Association.

Key Performance Indicators

Year ended
31 December 2017

Continued

Key performance indicator	What is measured	Performance	2017 update
Secure (continued)			
Net interest margin	The difference between interest received on assets and interest paid on liabilities, measured as a percentage of mean assets. This is the Society's main source of income.	**2017** 1.24% **2016** 1.37% **2015** 1.62% **2014** 1.58% **2013** 1.52%	Net interest margin reduced as expected due to lower margins on new business reflecting competition in the mortgage market. This meant net interest income increased at a lower rate than total assets.
Liquidity Coverage Ratio (LCR)	LCR is a measure of liquid assets which can be converted to cash to meet cash outflows in the event of a stress scenario (see page 16). The Society is required to maintain a minimum of 100% to meet regulatory requirements.	**2017** 198% **2016** 179% **2015** 194% **2014** 196% **2013** N/A	The Society maintained a strong level of liquidity in excess of internal requirements and the regulatory minimum.
Common Equity Tier 1 (CET1) ratio	The highest quality form of capital that mainly comprises retained earnings and other reserves, as a proportion of Risk Weighted Assets (RWAs). This is measured to ensure the Society retains an excess over the regulatory minimum.	**2017** 14.5% **2016** 15.2% **2015** 15.5% **2014** 15.6% **2013** 14.5%	CET1 capital has increased by £81 million through the strong profit performance. The CET1 ratio has fallen due to the growth in the balance sheet.
Leverage ratio	Another measure of capital strength. Measured as the Society's Tier 1 capital as a proportion of relevant total assets.	**2017** 5.0% **2016** 5.2% **2015** 5.5% **2014** 5.6% **2013** 5.3%	Leverage ratio has reduced as the Society has utilised some of its capital surplus to support strong growth. The ratio remains well above the regulatory minimum.
Credit ratings	The creditworthiness ratings assigned to the Society by Moody's and Fitch. Credit ratings are assigned following detailed analysis and can impact the amount the Society pays for new funding.	**Moody's:** Long term: A3 (2016:A2) Short term: P2 (2016: P1) **Fitch:** Long term: A- (2016: A-) Short term: F1 (2016: F1)	The Society was downgraded by Moody's during the year but retains a strong long term 'A' credit rating.
Service driven			
Number of days from mortgage application to offer	The number of business days it takes to issue a mortgage offer from initial receipt of the application.	**2017** 16 **2016** 19 **2015** 22 **2014** 23 **2013** 26	The continuing reduction is due to improvements in systems and processes and highlights the Society's commitment to appropriately streamlined processes.

Key performance indicator	What is measured	Performance	2017 update

Service driven (continued)

Key performance indicator	What is measured	Performance	2017 update
% of customer administration processing completed within service standards	The percentage of customer administration completed within agreed service levels.	2017: 90% 2016: 92% 2015: 93% 2014: N/A 2013: N/A	The 2017 performance reflects record levels of retail savings activity and increased mortgage retention, impacted by the November Bank of England base rate change.
Customer satisfaction	The percentage of customers surveyed who described themselves as quite, very or extremely satisfied with the service received from the Society.	2017: 91% 2016: 92% 2015: 91% 2014: 92% 2013: 93%	Customer satisfaction remained high and continues to benchmark favourably against other financial services organisations.
Colleague engagement score	Colleague engagement is measured annually across all colleagues. Society goals are delivered by highly engaged colleagues.	2017: 80% 2016: 78% 2015: 76% 2014: 76% 2013: 70%	Our colleagues remain highly engaged, with record levels of engagement of 80%, up from 78% in 2016.

Efficient

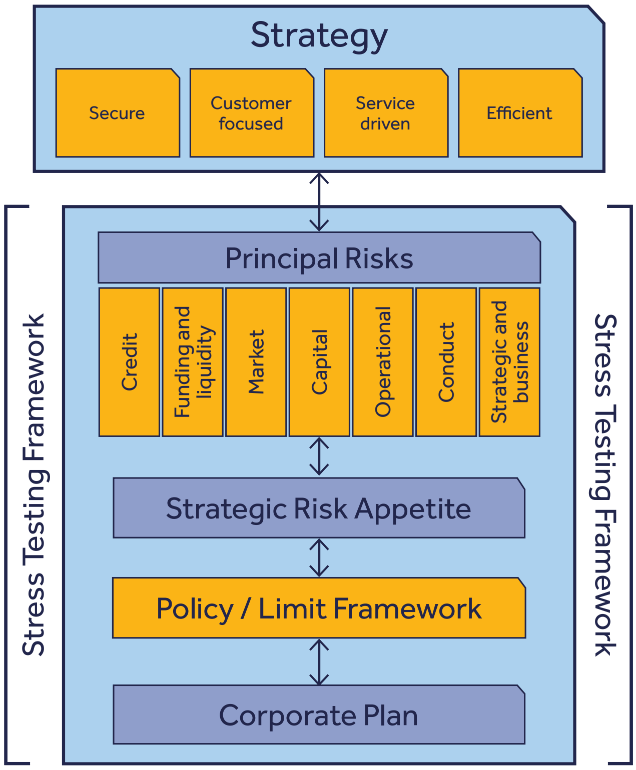
Key performance indicator	What is measured	Performance	2017 update
Cost to income ratio	A cost efficiency ratio which measures costs in relation to the Society's income. It is calculated as the percentage of the Society's total income spent on administrative expenses and depreciation and amortisation.	2017: 43.2% 2016: 43.3% 2015: 36.4% 2014: 33.4% 2013: 31.1%	Costs grew by 4%, which is less than in recent years, resulting in stabilisation in the cost to income ratio.
Cost to mean asset ratio	An additional cost efficiency ratio which measures costs in relation to the Society's total assets. It is calculated as administrative expenses plus depreciation and amortisation divided by the average total assets.	2017: 0.56% 2016: 0.62% 2015: 0.62% 2014: 0.57% 2013: 0.52%	Costs grew by less than the growth in the balance sheet, reflecting improvements in efficiency. The Society maintains a strong focus on cost management.
Colleague turnover	The proportion of colleagues who leave the Society during the year. The Society seeks to attract and retain the best people to deliver its goals.	2017: 18% 2016: 15% 2015: 14% 2014: 17% 2013: 19%	Colleague turnover remains within the Society's internal target. The increase in turnover in 2017 reflects changes to the branch model in the year.

Principal Risks

Year ended
31 December 2017

It is recognised that the Society's vision of becoming Britain's most successful building society can only be achieved if appropriate risk is taken and managed effectively. By understanding the nature of the risks the Society is exposed to, management is in a position to make informed decisions, supporting the longer term viability of the Society and protecting member interests.

The Society aims to deliver its vision through a corporate strategy, which is built upon four strategic pillars (as described on page 10). Inherent within this strategy, are seven principal risk categories: credit; funding and liquidity; market; capital; operational; conduct; and strategic and business risks. For each of these principal risk categories, the Society operates appropriate systems of control, including, but not limited to, Board defined Strategic Risk Appetite and a suite of Board approved policies. These set the risk parameters within which to deliver the Corporate Plan and also provide appropriate triggers for management response under stressed conditions.



These seven principal risk categories are influenced by underlying subsets of risk types, which comprise the Society's risk universe. Over time, the nature and profile of these underlying risks continue to evolve reflecting changes in the economic and business cycle and the current Society risk profile. Accepting that it is not possible to identify, anticipate or eliminate every risk that may materialise, and that risk is an inherent part of doing business, the Society's risk management processes (described on pages 54 to 57) aim to provide reasonable assurance that the Society understands, monitors and manages the main uncertainties, which the Society faces in achieving its objectives.

The Society formally reviews its principal risk categories on an annual basis, or intra-year in the event of material changes to its strategy or operating environment, with no changes being made in 2017. The current profiles of the principal risk categories are defined overleaf, along with how the Society seeks to mitigate these risks. While the Society is fundamentally a credit institution, the principal risk categories are not presented in order of materiality, as they all have the potential to affect future performance, depending on the prevailing circumstances. The Society's current top five risks, that could affect delivery of its strategy, and may cut across principal risk categories, are set out in the emerging risks section on page 19.

Principal risk	Mitigation	Commentary
Retail and commercial credit risk		
• The risk that residential or commercial borrowers are unable to make their loan payments. • This risk arises from the Society's residential lending activities and legacy credit portfolios.	• Focus on lending where the Society has specific expertise. • Board defined appetite, which is supported by policies, limit frameworks and management reporting. • Monthly review of performance versus appetite (more frequent during times of stress). • Robust underwriting processes, including the use of credit scoring models, affordability stress testing and suitably qualified underwriters. • Independent appraisal of collateral. • Retention of appropriately skilled colleagues to manage the ongoing wind down of the legacy euro and commercial portfolios. • Stress testing to assess vulnerabilities within credit portfolios and inform pre-emptive actions.	• The credit quality of the Society's residential portfolio continued to improve during 2017, with a reduction in non-performing loans. This reflects the application of robust credit disciplines, generally favourable economic conditions and the improved credit quality of borrowers. • The Society remains exposed to legacy mortgage portfolios in Ireland and Spain (less than 2% of total assets). These portfolios continue to be managed in line with the Society's work-out strategy. Brexit related risks associated with these assets are more operational in nature, rather than credit related, as referred to on page 19. • During 2017, the aggregate size of the Society's legacy commercial portfolio reduced further from £125 million to £72 million. Provisions held against these assets are in excess of any negative equity on the portfolio. • Since the Brexit vote, the Society has not observed any deterioration in portfolio performance (although refer to the emerging risks section on page 19).
Wholesale credit risk		
• The risk that wholesale counterparties default on their obligations. • This risk predominately emanates from the Society's liquidity holdings and derivative portfolio, which is used for hedging market risk.	• Board defined appetite, which is supported by the Wholesale Credit Policy (including concentration limits). • Monthly review of performance versus appetite (more frequent during times of stress). • Each counterparty line is reviewed at least annually, based on an internal analysis, credit default swap spreads, geographic location and other market intelligence. • A dedicated first line team monitors the portfolio on a daily basis, with oversight provided by the Risk Function. • Exchange of collateral through clearing and other netting arrangements for derivative exposures.	• During 2017, the composition and credit quality of the wholesale portfolio, relative to the Society's balance sheet and risk mitigation strategies, has remained stable. • As at the end of 2017, 93% (2016: 87%) of the portfolio was invested with UK-centric counterparties with an external credit rating of A- or better. • During the year, Moody's downgraded the UK sovereign credit rating to Aa2 and is now aligned to the other two major rating agencies. On this basis, the impact of the downgrade of the Society was neutral from a risk profile and capital adequacy perspective. • The majority of the Society's derivative portfolio is now centrally cleared, which mitigates bilateral counterparty risk.

Principal Risks

Year ended
31 December 2017

Continued

Principal risk	Mitigation	Commentary
Funding and liquidity risk		
• Liquidity risk is the risk that the Society is unable to meet its financial obligations as they fall due. • The Society's primary liquidity risk exposures arise through redemption of retail deposits, where customers are permitted to withdraw funds with limited or no notice. • Funding risk is defined as the inability to generate sufficient funding, or only do so at excessive cost. • Funding risk relates to the ability to generate new funding or re-finance the maturity of retail or wholesale funds.	• Board defined appetite, which is supported by the Funding and Liquidity Policy (including concentration limits). • Monthly review of performance versus appetite (more frequent during times of stress). • Maintenance of a portfolio of high quality liquid assets based on stressed requirements, as determined through the Board approved Internal Liquidity Adequacy Assessment Process (ILAAP). • The Treasury Function monitors the Society's liquidity position daily, with oversight provided by the Risk Function and reporting to the Assets and Liabilities Committee. • Frequent stress testing to understand the impact of severe but plausible scenarios and to inform pre-emptive actions. • Access to central bank funding, through prepositioned collateral. • Maintenance of a recovery plan, which includes liquidity management actions.	• As at the end of 2017, the Society retained a strong liquidity position (LCR of 198%; 2016: 179%) which was comfortably above minimum regulatory requirements. • The Society's funding profile remains predominately funded by retail savings (76% of shares, deposits and liabilities; 2016: 76%) through a strong retail franchise. • The Society also supports funding requirements through its well established wholesale franchise. Here the Society retains access to capital markets through a diversified investor base. During 2017, the Society utilised this investor base to issue a €500 million covered bond. • Capital market access is also supported by the Society's strong credit ratings, notwithstanding a downgrade by Moody's during the year.
Market risk		
• The risk that market movements adversely impact the Society. • The Society's market risk exposures mainly relate to interest rate risk in the banking book (including basis and optionality risks) and foreign currency risk (including redenomination risk).	• Board defined appetite, which is supported by the Market Risk Policy (including concentration limits). • Monthly review of performance versus appetite (more frequent during times of stress). • The offsetting of assets and liabilities and use of derivatives to manage market risk positions. • A dedicated first line team monitors the Society's market risk exposures frequently, with oversight provided by the Risk Function. • Frequent stress testing to understand the impacts of movements in interest and foreign exchange rates on the Society to influence the desired balance sheet shape.	• During 2017, the Society's market risk exposure profile, relative to its balance sheet and its approach to managing the risks inherent in it, has remained broadly similar through the period. Therefore, associated risk levels have remained generally stable against agreed internal limits and appetite. • The Society continues to evaluate and monitor the impact of macro-economic and market competition risk on its interest rate risk strategies and positions, as set out in the emerging risks section on page 19.

Principal risk	Mitigation	Commentary
Capital risk		
• The risk that the Society has insufficient quality or quantity of capital resources to meet current or future business requirements. • This risk can arise as a result of a lack of supply of internally generated or publicly financed capital, or an increase in requirements owing to an increase in risk profile or regulatory changes.	• Board defined appetite, which is supported by the Capital Policy and Capital Strategy. • Monthly review of performance versus appetite. • Conducting an Internal Capital Adequacy Assessment Process (ICAAP), at least annually, to determine the level of capital required to support current and future business activities. • A dedicated first line team monitors the Society's capital position, with oversight provided by the Risk Function. • Stress testing to understand the impact on the Society's capital position, under a range of severe but plausible scenarios. • Maintenance of a Recovery Plan.	• The Society maintains strong capital ratios, with capital resources significantly above minimum regulatory requirements. • As at the year end, the Society's CET1 ratio stood at 14.5% (2016: 15.2%), while the leverage ratio was 5.0% (2016: 5.2%). This reduction reflects the planned use of capital during the year. • The Society continues to develop its IRB capabilities. In due course, this approach should allow the Society to apply internally derived risk weights to determine capital adequacy, reflecting the specific risks associated with the Society's mortgage book.This is subject to regulatory authorisation. • The Society continues to plan for, and respond to regulatory reforms in respect of capital, including the impacts of MREL.
Operational risk		
• The risk of financial or reputational loss, as a result of inadequate or failed processes, people, systems or external events. • The drivers of operational risk are: legal and regulatory; people; information security, IT, business continuity, data, financial crime, process and financial reporting risks.	• Board defined appetite, which is supported by an appropriate suite of operational risk related policies. • Monthly review of performance versus appetite. • Established process for the identification, assessment, management and reporting of operational risk exposures. • Clear incident management and breach reporting framework and protocols. • Risk Control Self-Assessments, control testing and oversight procedures to validate the control environment. • A people strategy to ensure that colleagues possess the necessary skills and knowledge to fulfil their role. • Maintenance of a programme of IT resilience and business continuity testing. • Scenario analysis and associated response plans.	• During 2017, the Society made further investment in systems across the operational risk universe to enhance the control environment, including: IT and cyber capabilities, financial crime and a new operational risk system. • Further refinements to the Society's operational capability and resilience continue to be evaluated to ensure that defences and controls remain commensurate to the Society's operating environment and risk profile. • The threat landscape for cyber events continues to evolve at pace and shows no sign of abating. This is discussed further in the emerging risks section on page 19.

Principal Risks

Year ended
31 December 2017

Continued

Principal risk	Mitigation	Commentary
Conduct risk		
• The risk that actual or potential customer detriment arises, or may arise, from the way the Society conducts its business. • This risk arises from the design and ongoing suitability of the Society's products and pre and post sales services.	• Board defined appetite, which is supported by the Conduct Risk Policy. • The Society operates a simple business model with limited complexities that could adversely impact customers. • The Society only develops products that meet the needs of its customers, through a Product Governance Framework. • Processes and controls are in place to ensure product literature is clear and transparent. • Customer facing colleagues are suitably trained, with competency assessed on an ongoing basis. • The Society conducts customer satisfaction surveys to understand performance against customer expectations. • The Society's Complaints Handling Policy and supporting arrangements ensure that complaints are addressed with empathy and sensitivity through a fair and transparent process.	• During 2017, oversight teams continued to deliver risk based plans to monitor conduct risks, the results of which were reported to the Conduct Risk Committee. • While there has been no significant overall movement in the Society's conduct risk profile, the volume and scale of regulatory change has meant that the Society has had to direct significant project and compliance resources in this area, including its preparations for key regulatory reforms such as General Data Protection Regulation (GDPR) and the Payment Services Directive 2 (PSD2).
Strategic and business risk		
• The risk that the Society is unable to deliver its strategic objectives. • This risk mainly relates to poor execution of the Society's strategy or changes within its operating environment.	• Board defined appetite, which is supported by a suite of appropriate policies. • The Board approved corporate planning process makes an assessment of the business environment on a quarterly basis. • Enterprise risk reporting, including horizon scanning assesses the Society's general operating environment. • The Society utilises stress testing to understand its performance under a variety of severe but plausible scenarios.	• During 2017, Brexit and the associated uncertainty, has continued to provide the backdrop to the Society's operating environment. While the economy has remained relatively resilient to date, the heightened levels of economic and political uncertainty remain. • Competition within the Society's core markets remains strong from established players and new entrants. The impact of increased competition continues to reduce margins. • Customer preference for different mortgage and savings durations can also create different levels of balance sheet transformation risk.

Emerging risks

Within the context of its principal risk categories, the Society continues to identify, assess and monitor emerging risks through its Risk Management Framework, described on page 54. These are new or evolving risks where the probability of occurrence and impact are uncertain. In assessing emerging risks, the Society considers the likelihood of the relevant risk materialising and the potential impact on its business strategy and stakeholders. These risks are considered by management, as part of its strategic and business planning processes. As at the end of 2017, the Society considered the following as its top emerging risks:

Macro-economic and political risk

The Brexit negotiations continue to provide the backdrop to the UK economy. While the UK and EU agreed to progress to the second stage of exit negotiations towards the end of 2017, there remains a significant amount of uncertainty regarding the future relationship between the two parties and any associated regulatory change. As a UK-centric business, the Society has limited direct exposure to the EU. However, the wider impacts of the UK leaving the EU, without transitional or longer term trade arrangements in place, would likely have more material implications for the UK economy and hence the Society.

The UK economy is also exposed to several other material downside risks, such as heightened levels of household debt, elevated house prices in certain regions and a minority government. Crystallisation of these risks could impact the wider economy and the Society.

The Society considers macro-economic and political risks on a regular basis, under both central and stressed conditions in order to understand the impact on its business model. With regard to Brexit, the Society is currently progressing options in relation to its legacy operations in Ireland and Spain.

Competition risk

The nature of the competitive environment highlights a number of evolving risks. Increased competition from established lenders, as a result of ring fencing requirements, and new market entrants, such as challenger banks and 'Fintech' companies, alongside the development of new IT software solutions could potentially threaten the Society's core market proposition. Furthermore, the closure of the Term Funding Scheme in February could increase competition within the retail savings marketplace. The combination of these competitive pressures could result in higher levels of customer attrition and lower margins.

The Society carefully considers these risks as part of its strategic and business planning activities, which will enable it to adapt accordingly.

Regulatory change risk

The volume, scale and complexity of regulatory change continues to shape the Society's operating environment and show no signs of abating. There are currently a significant number of regulatory initiatives in the process of implementation, from the Society's respective regulators, which may require prioritisation over business led initiatives.

The Society closely monitors upstream regulation, with developments managed through an effective oversight framework, which allows management to respond in an efficient and appropriate manner.

Cyber risk

Cyber crime is an increasing threat across both financial and non-financial industries as organisations take advantage of new digital technologies in their product and service propositions. The frequency and sophistication of these threats continues to evolve and increase, as demonstrated by several high profile cases during 2017, for example WannaCry and NotPetya.

In response, the Society is implementing a Board approved cyber strategy. This is focused on continuing to enhance its IT and information security resilience through both technology and colleague awareness, as well as ensuring that appropriate systems of control exist to monitor the threat landscape to protect the Society and member assets.

Outsourcing risk

The Society manages strategic relationships with a number of third parties who support the origination of mortgage business and key components of the Society's infrastructure. Reliance on key corporate partners and strategic suppliers gives rise to the potential risk of disruption.

In recognition of this, the Society maintains appropriate control and oversight arrangements of its third party suppliers, both in terms of the on-boarding process and ongoing management.

Andrew Greenwood
Chief Risk Officer

27 February 2018

Viability Statement

Year ended
31 December 2017

In accordance with the UK Corporate Governance Code, the directors have formally assessed the longer term viability of the Group and the Society over a three year period to 31 December 2020.

The three year review period is considered appropriate for the following reasons:

- uncertainty regarding the economic, competitive and regulatory environments beyond the three year period reduces the reliability of a longer assessment of viability;
- a significant proportion of the Society's assets and liabilities are expected to mature within three years; and
- key drivers of financial performance such as net interest income and impairment losses are heavily influenced by the level of market interest rates, house prices and unemployment which are difficult to predict beyond a three year horizon.

The Group's business model and strategic priorities are set out on pages 8 to 10. The directors have assessed the prospects and viability of the Group, taking into account its current financial position and considering the potential impact of the principal risks set out on pages 14 to 19. The assessment has also considered the potential impacts of new and emerging regulation where sufficient information is known over future requirements, such as MREL.

The corporate planning process assesses the forecast financial performance of the Society under a range of stress scenarios against the Society's strategic risk appetite. The following risk factors were specifically considered in the modelled scenarios:

- a reduction in Bank of England Base Rate to 0%;
- a significant increase in market interest rates;
- an increase in funding costs relative to market interest rates;
- adverse impacts of high levels of customer indebtedness on the mortgage market; and
- a sudden downturn in the buy to let mortgage market.

The directors have also reviewed the Society's longer term viability from a capital and liquidity perspective through the ICAAP and the ILAAP. These processes assess the Society's ability to withstand severe capital and liquidity stresses, in line with regulatory requirements. They take into account potential management actions and consider the impact and credibility of those actions in mitigating the potential impacts of the stresses applied.

The ICAAP concluded that the Society maintains sufficient capital resources to meet regulatory requirements under the central planning scenario and also, with management action to reduce the level of new lending, under the modelled economic stress scenario.

Similarly, the ILAAP concluded that the Society is able to meet both internal risk capacity requirements and regulatory requirements under modelled stress scenarios.

Additionally, for each of the principal risks identified on pages 14 to 19, reverse stress testing has been performed to understand the ability of the Society to withstand the most extreme stress scenarios, including unprecedented adverse movements in key economic indicators, major dislocation and volatility in financial markets, significant liquidity outflows and severe operational risk events.

Based on the above assessments, the directors conclude that:

- The Group maintains an appropriate level of liquidity that is sufficient to meet both the normal demands of the business and the requirements which might arise in modelled stressed circumstances. The availability and quality of liquid assets are structured so that funds are available to repay any maturing wholesale funds and cover exceptional demand from retail investors.
- The Group's current capital resources and plans for future capital generation, are sufficient to maintain capital in excess of current and known future regulatory requirements, under both central and modelled stressed scenarios.
- While it is accepted that it is not possible to completely eliminate all risk, the Group has taken reasonable steps to put in place suitable operational capabilities to manage and mitigate the impacts of risk events to within reasonable tolerances.

Therefore, the directors have a reasonable expectation that the Society will be able to continue in operation and meet its liabilities as they fall due over the three year period to 31 December 2020.

Robin Litten
Chief Financial Officer

27 February 2018

Financial Review

Year ended
31 December 2017

The Society delivered a strong financial performance in 2017, which is summarised below along with a review of the financial position at the end of the year.

This report includes a number of alternative performance measures (APMs) which provide useful additional information about the Society but are not defined under the requirements of International Financial Reporting Standards. Further information on the calculation of APMs and reconciliation to an equivalent statutory measure, can be found on pages 146 to 148.

Income statement overview

The income statement for the year is summarised below:

	2017 £m	2016 £m	Change
Net interest income	213.2	201.8	6%
Fees, commissions and other income	9.1	11.5	(21%)
Fair value gains less losses	(1.3)	(1.3)	–
Total income	**221.0**	**212.0**	**4%**
Management expenses	(95.5)	(91.9)	4%
Impairments on loans and advances to customers	5.5	0.9	>100%
Other impairments and provisions	(10.1)	(4.4)	>100%
Profit before tax	**120.9**	**116.6**	**4%**
Tax expense	(32.9)	(30.6)	8%
Profit after tax	**88.0**	**86.0**	**2%**

Profit before tax grew by £4.3 million to £120.9 million, driven by an increase in net interest income and increased impairment releases on loans and advances to customers, which more than offset a reduction in other income and increases in management expenses and other impairments and provisions.

The increase in net interest income was driven by growth in total assets, although net interest margin reduced due to lower margins on new lending and reductions in Standard Variable Rate (SVR) balances, as customers moved to new rates. Management expenses increased modestly to accommodate inflation and continued investment.

Net interest income

The net interest income summary for the year is set out below:

	2017 £m	2016 £m	Change
Net interest income	213.2	201.8	6%
Mean total assets	17,207	14,718	17%
	%	%	Change
Net interest margin	1.24	1.37	(0.13)

Net interest income for the year was £213.2 million, which represented a 6% increase over 2016. This was primarily driven by the increased size of the balance sheet, with net interest margin reducing as expected. Net interest income is the Society's main source of income and it continues to balance the need to offer competitive rates to new and existing borrowers and savers.

The key features of net interest income in 2017 are:

- Low interest rates and increased competition have meant that margins on new lending continued to reduce. The Society continues to offer competitive products when initial product rates end in order to retain existing customers, resulting in a reduction in the proportion of customers paying SVR.
- Savings rates in the market have continued to reduce during 2017. The Society maintained competitive rates in order to provide value to members and to meet retail funding requirements. During the year the Society simplified the structure of rates across its range of savings accounts, paying at least 0.5% on all accounts. On average the Society paid 1.33% (2016: 1.66%) on its savings range, compared to the market average of 0.70%[1] (2016: 0.97%).

The trend to lower net interest margin is expected to continue, with competition in the mortgage and savings markets continuing to encourage product switching. Despite the increase in Bank of England Base Rate in November, interest rates remain low.

1. CACI CSDB, Stock, January 2017 – December 2017, latest data available. CACI is an independent company that provides financial services benchmarking data and covers 86% of the high street cash savings market.

Fees, commissions and other income

The Society has a number of partnerships with third parties who offer additional products to members. These include home insurance, life cover, funeral planning and probate services.

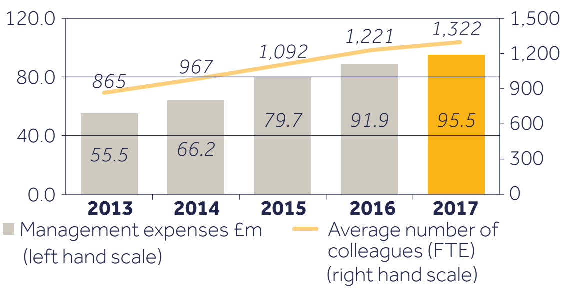
Other income comprises commissions earned on these products, together with rental income, foreign exchange movements and other ancillary fees. In 2017, other income reduced to £9.1 million (2016: £11.5 million), due to lower commission income and lower foreign exchange gains.

Management expenses

Management expenses for the year are summarised below:

	2017 £m	2016 £m	Change
Colleague costs	56.7	53.9	5%
Other administrative expenses	35.8	34.8	3%
Depreciation and amortisation	3.0	3.2	(6%)
Total management expenses	**95.5**	**91.9**	**4%**
	%	%	Change
Cost to income ratio	43.2	43.3	(0.1)
Cost to mean asset ratio	0.56	0.62	(0.06)

Management expenses £m and colleague numbers



Management expenses have grown over recent years as the Society has invested in the business in order to grow and meet the changing needs of members, while maintaining the infrastructure required to operate in a highly regulated environment.

The growth in management expenses was lower than in recent years, with a 4% increase in 2017 to £95.5 million. The cost to income ratio remained broadly flat at 43.2%, while the cost to mean asset ratio fell 6 basis points to 0.56%, reflecting improvements in efficiency. The Society's expense ratios remain among the lowest in the building society sector.

Colleague costs continue to represent the majority of the Society's cost base. The average number of colleagues (FTE) rose by 8% in 2017, resulting in an increase in colleague costs, although this was primarily due to the full year impact of significant recruitment in 2016.

Other administrative expenses increased due to higher technology costs as the Society continues to invest in this area and move towards a more customer-centric digital business.

The sustained investment over recent years has ensured the Society is well placed for the future. The Society will continue to balance the need to invest in the business with the need to maintain a sustainable, low cost base.

Fair value gains less losses

Fair value movements represent changes in the value of certain financial assets and liabilities, mainly derivatives, to reflect their current market value. The income statement impact is mitigated to an extent through the use of hedge accounting. Changes in fair value are primarily due to timing differences, which will trend to zero as the asset or liability reaches maturity. Fair value movements in 2017 resulted in a charge of £1.3 million, in line with 2016.

Impairments and provisions

The table below summarises the impact of impairments and provisions in the year:

	2017 £m	2016 £m	Change
Residential loans	1.4	4.9	(71%)
Commercial loans	(6.9)	(5.8)	19%
Intangible assets	5.6	-	-
Property, plant and equipment	0.9	0.5	80%
Other provisions	3.6	3.9	(8%)
Total impairments and provisions	**4.6**	**3.5**	**31%**

Overall, in 2017 the Society recorded charges of £4.6 million in relation to impairments and provisions, compared to £3.5 million in 2016.

Continued

Residential impairment
The continued benign economic environment and low interest rates have contributed to an improvement in the arrears ratio (measured as those either in possession or arrears of more than 1.5% of the balance) to 0.70% at 31 December 2017 (2016: 1.02%). This, combined with increases in house prices, caused total losses and impairment charges for residential loans to reduce to £1.4 million (2016: £4.9 million).

The Society has total balance sheet impairment provisions against residential mortgages of £23.8 million (2016: £26.0 million). The specific provision of £15.8 million, as a percentage of loans in arrears and possession, is 14.6% (2016: 10.5%).

Commercial impairment
The Society does not make new commercial loans and is actively managing down the legacy commercial lending portfolio. The Society's exposure to commercial loans has fallen to £72 million (2016: £125 million). Realised losses were lower than anticipated and consequently a credit of £6.9 million (2016: £5.8 million credit) has been recognised in the year.

The Society has balance sheet impairment provisions against commercial mortgages of £17.2 million (2016: £25.7 million). The specific provision of £13.6 million as a percentage of impaired loans is 35% (2016: 40%). The negative equity in the portfolio remains fully covered by provisions.

Impairment of intangible assets
The Society incurred a charge of £5.6 million relating to the costs of an element of technology development which was ceased prior to completion.

Impairment of property, plant and equipment
Following the acquisition of a new Head Office property, the Society has impaired certain fixtures and fittings within existing properties which will not be utilised at the new property, at a cost of £0.9 million.

Other provisions
The majority of the provision charges in the year relate to customer redress payments, with a charge of £3.2 million (2016: £1.6 million). The charge reflects the expected level and value of claims plus the costs of investigating them, particularly in respect of mortgage payment protection insurance, taking into account the expected impact of the claims deadline in 2019 and the Plevin ruling. A provision has also been made for potential costs in relation to the failure of one of the Society's third party product providers.

As a regulated deposit taker, the Society is a member of the Financial Services Compensation Scheme (FSCS), which compensates savers and investors for losses incurred when other institutions fail. During 2017 the charge for the FSCS levy reduced to £0.2 million (2016: £2.3 million) following the sale of assets by UK Asset Resolution in March 2017, which were funded by the FSCS.

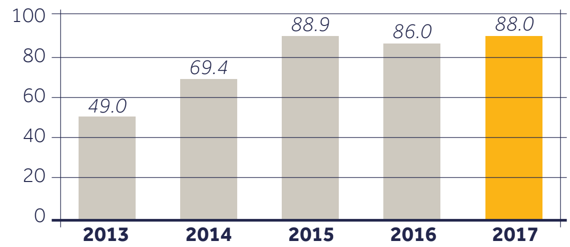
Taxation
The income tax expense of £32.9 million (2016: £30.6 million) represents 27.2% (2016: 26.2%) of profit before tax and is in line with the prevailing rate of corporation tax of 19.25% for 2017 (2016: 20%) and the 8% surcharge on banking profits over a £25 million threshold introduced in 2016.

The Society has adopted the Code of Practice on Taxation for Banks and has established appropriate procedures, controls and oversight to ensure it meets its obligations under the Code. The Society manages its tax obligations to ensure full compliance with all statutory requirements and does not intentionally structure transactions to give a tax result which is contrary to the intentions of Parliament. The Society maintains an open and transparent relationship with HMRC. A tax policy has been agreed by the Audit Committee which provides a framework for the operation, planning and oversight of tax and tax risk to ensure compliance with relevant legislation. Updates are provided to the Audit Committee in line with the tax policy.

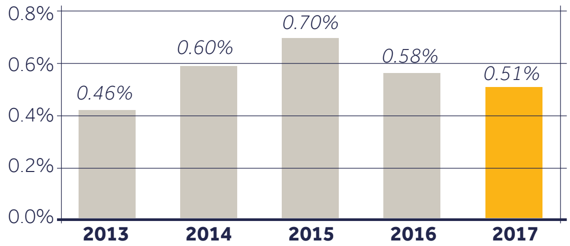
Profit after tax
Profit after tax is the primary source of new capital for the Society and is essential in ensuring its long term security for members, as well as meeting the regulator's capital requirements. The level of profit generated by the Society is sufficient to support future lending plans.

The Society continues to generate a stable level of profits, with profit after tax for 2017 increasing 2% over 2016 to £88.0 million. Profit after tax as a percentage of mean assets reduced due to the lower net interest margin.

Profit after tax £m



Profit after tax as % of mean assets



Balance sheet

Total assets increased by 16%, to £18.5 billion, driven by the continued strong growth in core residential lending.

	2017 £m	2016 £m	Change
Residential loans	14,932	13,082	14%
Commercial loans	72	125	(42%)
Other loans	250	255	(2%)
Impairment provision	(44)	(54)	(19%)
Loans and advances to customers	**15,210**	**13,408**	**13%**
Liquid assets	2,730	1,904	43%
Derivative financial instruments	259	263	(2%)
Fixed and other assets	285	355	(20%)
Total assets	**18,484**	**15,930**	**16%**

Asset quality

Residential mortgages:	**%**	**%**	**Change**
Proportion of mortgages in arrears	0.70	1.02	(0.32)
Balance-weighted average indexed LTV of mortgage book	55.6	56.8	(1.2)
Balance-weighted average LTV of new lending	63.9	65.2	(1.3)
Commercial lending:	**£m**	**£m**	**Change**
Total commercial lending balances	72	125	(42%)
Impaired balances	39	50	(22%)

Loans and advances to customers

The majority of the Society's loans and advances to customers are UK residential mortgages, including residential owner-occupied, buy to let and shared ownership. The Society does not make new commercial loans and is actively managing down the legacy commercial loan portfolio. The Society also has some overseas balances relating to historic legacy lending activity. These balances make up less than 2% of the Society's loan balances and the Society is no longer active in these markets.

Other loans include a collateral loan, which represents a portfolio of equity release mortgages purchased from a third party, where some of the risks relating to those mortgages were retained by the third party.

New lending

Gross lending during the year was £4.1 billion, an increase of £0.1 billion compared to the previous year. The Society's share of new mortgage lending was 1.6% (2016: 1.6%), significantly higher than its natural market share of 1.1% (2016: 0.9%)[2] . Net lending was £1.8 billion in 2017, £0.1 billion lower than the previous year.

The current level of gross lending reflects the Society's strategy of utilising its funding capacity and strong capital position to support a wide range of borrowers. The Society has a particular focus on borrowers in specific segments, such as buy to let or shared ownership.

Gross lending to these segments has grown in the year, with residential owner-occupied lending representing less than half of new lending. The focus on higher margin lending supports the Society's profitability and thus strengthens its position for existing and future members, while remaining within risk appetite.

The Society maintains a conservative lending policy, which is reflected in the distribution of loan to value (LTV) ratios. The average LTV of new lending in 2017 was 64% (2016: 65%).

2. Leeds Building Society defines market share as follows:
Mortgages – Market share statistics published by UK Finance
Savings – mutual sector net retail savings as published by the Building Societies Association.

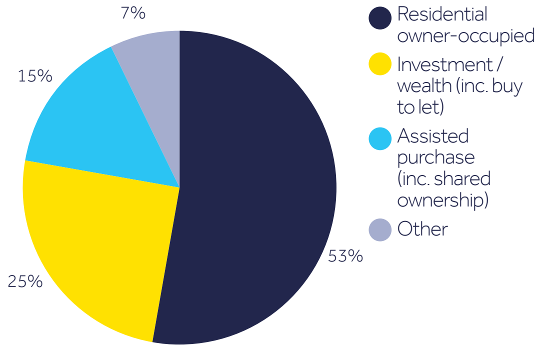
Year ended
31 December 2017

Continued

UK residential mortgage balances

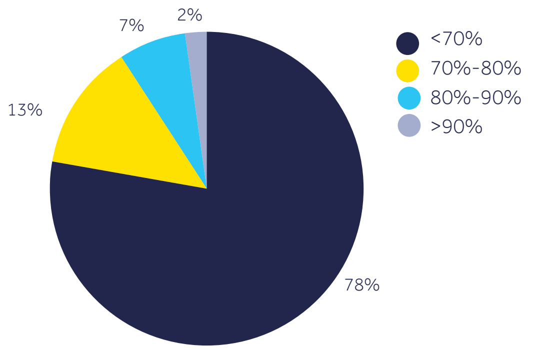
The focus on lending to specific segments means these balances now make up almost half of UK residential mortgage balances, as illustrated in the chart below:

2017 UK residential mortgage balances by type



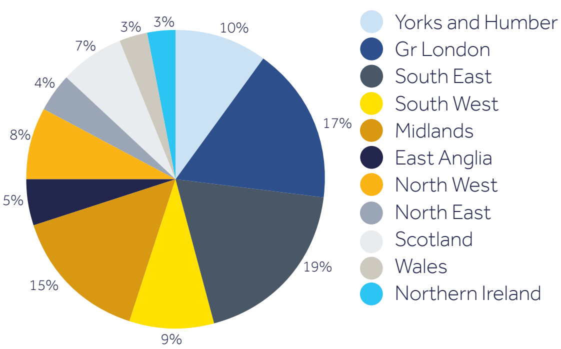
At 31 December 2017 the weighted average indexed LTV of the portfolio as a whole was 56% (2016: 57%). A full analysis of the LTV profile of the portfolio is shown below:

2017 UK residential mortgage balances by indexed LTV



The portfolio is geographically diverse with the largest exposures in Greater London and the South East, reflecting the higher property prices in this area.

2017 UK residential mortgage balances by region



Liquid assets

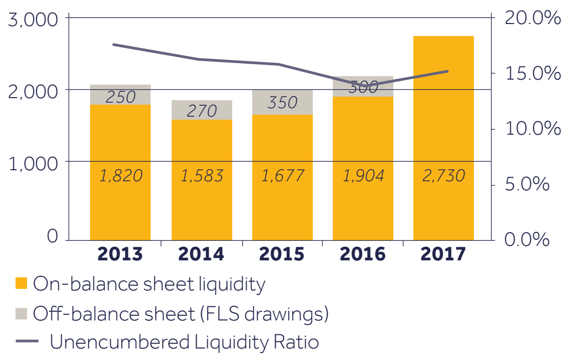
Liquidity ratios	2017 %	2016 %	Change
Liquidity Coverage Ratio (LCR)	198	179	19
Net Stable Funding Ratio (NSFR)	135	131	4
Total unencumbered liquidity	14.8	14.0	0.8

The Society holds liquid assets (including reserves with the Bank of England and other High Quality Liquid Assets) to ensure it can meet its financial obligations under both normal and stressed scenarios. The Society has maintained liquidity in excess of the regulatory minimum throughout the year.

The chart below shows the Society's total liquid assets, including on-balance sheet liquid assets and, in previous years, off-balance sheet assets held as a result of drawings from the Bank of England's Funding for Lending Scheme (FLS). During the year, all drawings from this scheme were replaced by on-balance sheet funding from the Term Funding Scheme (TFS).

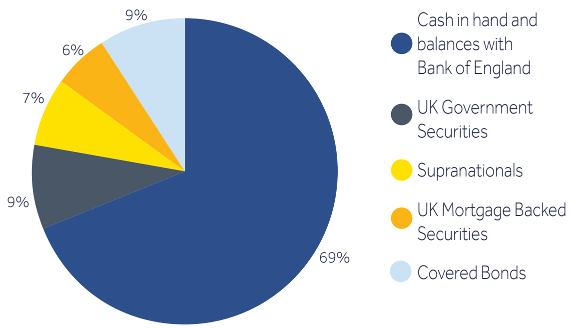
The Society also has access to additional contingent liquidity through the Bank of England's Sterling Monetary Framework and the European Central Bank.

Liquidity £m / %



Total liquid assets at the end of 2017 were £2.7 billion, compared to £2.2 billion at the end of 2016. The level of liquidity can vary due to the timing of funding receipts compared to mortgage completions and other refinancing obligations. Liquidity included £2.5 billion of High Quality Liquid Assets (2016: £2.0 billion), which are either in cash or are readily realisable as cash when required. 99% of assets are rated 'A' or better (2016: 99%).

2017 Liquidity portfolio



The Prudential Regulation Authority (PRA) monitors liquidity under the Capital Requirements Directive IV (CRD IV) framework. The Society's LCR is 198% (2016: 179%), in excess of the regulatory minimum, which will be 100% when the measure is fully implemented. The NSFR is currently calculated based on the Society's interpretation of expected requirements as 135% (2016: 131%).

The Society's unencumbered liquidity ratio, which represents liquid assets as a proportion of shares, deposits and liabilities, was 14.8% at 31 December 2017 (2016: 14.0%).

Freehold premises

In December 2017, the Society acquired a freehold office property which is intended to become its new Head Office.

Liabilities

A summary of the Society's liabilities is below:

	2017 £m	2016 £m	Change
Shares	13,072	11,202	17%
Wholesale funding	4,061	3,401	19%
Derivative financial instruments	162	214	(24%)
Other liabilities	230	239	(4%)
Total liabilities	**17,525**	**15,056**	**16%**
Equity attributable to members	959	874	10%
Total liabilities and equity	**18,484**	**15,930**	**16%**

Key ratios	**%**	**%**	**Change**
Wholesale funding ratio	22.2	21.7	0.5

Achieving an appropriate level, mix and duration of retail savings and wholesale funding is essential to ensure the Society has the necessary resources to meet its lending growth aspirations.

Shares

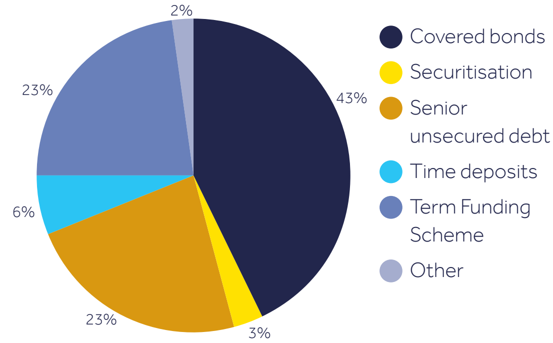
The Society continues to offer competitive savings rates to both existing and new members with a simple product proposition. This led to savings balances increasing by £1.9 billion in the year and represented growth of 17% to a record £13.1 billion (2016: £11.2 billion).

Wholesale funding

The Society continues to access wholesale markets to complement its retail savings activity. The Society seeks to maintain wholesale balances at approximately one fifth of total funding, although the Society seeks to take advantage of favourable funding conditions and thus the proportion of wholesale funds can increase above this level. Total wholesale funds at 31 December 2017 were £4.1 billion (2016: £3.4 billion), representing 22.2% of total funding.

During the year, the Society raised €500 million under its covered bond programme, and drew down £300 million of funding from the TFS, bringing total drawings under the TFS to £850 million.

2017 wholesale funding portfolio



The Society maintains strong credit ratings from two key agencies. The Society was downgraded by Moody's during the year as it reassessed its view of the UK economy and the Society's resultant exposure to a downturn. The Society still maintains 'A' long term ratings, reflecting the strong capital position, good profitability and strong funding position.

	Long Term	Short Term	Outlook
Moody's	A3	P-2	Stable
Fitch	A-	F1	Stable

Capital

The Society's capital resources, requirements and ratios are presented below:

Capital resources	2017 £m	2016 £m	Change
Total equity attributable to members	959	874	10%
Less pension surplus, intangible assets and other regulatory adjustments	(7)	(3)	>100%
Common Equity Tier 1 (CET1) capital	952	871	9%
Additional Tier 1 capital	12	15	(20%)
Total Tier 1 capital	964	886	9%
Tier 2 capital	24	28	(14%)
Total regulatory capital resources	988	914	9%
Risk-weighted assets (RWAs)	6,577	5,731	15%
CRD IV capital ratios	**%**	**%**	**Change**
CET1 ratio	14.5	15.2	(0.7)
CRR leverage ratio	5.0	5.2	(0.2)
UK leverage ratio	5.5	5.6	(0.1)

A strong capital position was maintained throughout the year, with all capital ratios significantly in excess of regulatory minima.

CET1 capital resources have increased by £81 million during 2017, as a result of the strong profit performance. Key capital ratios decreased in the year, reflecting the growth in residential lending. Balance sheet growth is planned and managed to ensure good use of the Society's resources, while maintaining a strong capital position.

The CET1 ratio decreased to 14.5% (2016: 15.2%). The total capital ratio (including other eligible capital items) was 15.0% (2016: 15.9%). The CRR leverage ratio, a non risk-based capital measure, reduced to 5.0% from 5.2%. On a modified basis, excluding Central Bank reserves, the Society's leverage ratio is 5.5% (2016: 5.6%), compared to an expected regulatory minimum of 3.25%.

The Society continues to develop Internal Ratings Based (IRB) capabilities for credit risk management. Subject to regulatory authorisation, this approach should allow the Society to apply internally determined risk weights to determine capital adequacy, reflecting the specific risks of the Society's mortgage book.

The Society's future capital plans incorporate requirements for MREL and other expected changes to the capital regime for banks and building societies, including risk weighted capital floors and the impact of IFRS 9. Consequently, the Society remains well placed to meet regulatory capital requirements as they continue to evolve.

IFRS 9

IFRS 9: Financial Instruments takes effect from 1 January 2018. The standard changes the classification and measurement of financial instruments, changes the current incurred loss basis for calculating impairment provisions to an expected loss basis and introduces new rules for hedge accounting.

The only material impact on the Society's financial statements is the change to impairment provisions. These changes mean that impairment losses are recognised at an earlier point in the life cycle of a financial instrument, but do not change the actual losses incurred on that instrument. This will result in an increase in the impairment loss provisions held against loans and advances to customers on the date of implementation of IFRS 9.

Oversight of progress on the Society's IFRS 9 implementation project is provided by the Audit Committee. The expected credit loss models have been developed in accordance with the Society's modelling policies and standards and were approved by the Models and Rating System Committee. The models will be subject to ongoing monitoring, calibration and review in line with policy. Macroeconomic input assumptions are approved by the appropriate committees.

The initial impact of adoption of IFRS 9 is expected to result in impairment loss provisions of between £65 million and £70 million, compared to the current IAS 39 provisions of £44 million. Further details are shown in the notes to the accounts, on page 95.

Financial outlook

2017 has been another successful year for the Society as it has further increased profit, attracted record levels of savings balances and new mortgage business and remains financially strong.

During 2018, we anticipate that competition in the mortgage market will intensify, creating continuing downward pressure on margins and uncertainty around leaving the EU may cause volatility in financial markets.

Nevertheless, the Society retains a strong franchise in mortgage lending and retail savings which will help it continue to grow and its strong efficiency ratios and conservative risk appetite is expected to support continuing strong profitability underpinning the financial security that is so important to members' confidence.

Robin Litten
Chief Financial Officer

27 February 2018

Colleagues

Year ended
31 December 2017

The aim of our people strategy is to deliver value to a growing membership through highly engaged colleagues. We are very proud of the contribution made by all our colleagues and the service they provide to our members. Our colleague engagement is measured through our Your Voice survey and Best Companies accreditation.

Our people strategy is underpinned by our culture, which we define as colleagues 'living our values'. Quite simply, it is how we do things and what is important to us. Our values, collaborative, straightforward, progressive, integrity, passionate and responsible, set the framework for how we conduct ourselves for our members, our stakeholders and each other. All our people practices are aligned to our values, including recruitment and selection, performance management, learning, reward, talent development and succession planning, as well as our risk management and audit frameworks. Specifically, our values align to our regulators' Conduct Rules, setting the standards for how our people work.

Diversity and inclusion

In 2017, we launched our diversity and inclusion strategy, with a single stated ambition 'to have an inclusive culture, which enables colleagues with a diverse range of skills, experiences, backgrounds and opinions to flourish, without barriers'.

Colleagues living our values supports the delivery of our diversity and inclusion aims and significant progress has been made to date, on a number of key initiatives. We:

- continue to be a signatory to HM Treasury's Women in Finance Charter and have set ourselves targets for gender representation on our Board and within our senior management teams;
- achieved Investors in Diversity status in 2016, being the first financial services organisation to achieve this and we are working on our commitments to achieve Leaders in Diversity status in 2018; and
- have trained all our colleagues in understanding both diversity and inclusion and unconscious bias, to help support our aims.

Information on the composition of the workforce at the end of the year is shown below:

		2017 Females	**2017 Males**	2016 Females	2016 Males
Colleagues	Number	811	492	837	505
	Percentage	62%	38%	62%	38%
Managers	Number	31	56	25	48
	Percentage	36%	64%	34%	66%
Directors	Number	3	10	3	10
	Percentage	23%	77%	23%	77%

At the end of 2017, 119 colleagues were from ethnic minorities, comprising 8% of the workforce (2016: 91 colleagues; 6%).

Our first diversity and inclusion priority for 2018 is to continue to build our female talent pipeline in support of more balanced gender diversity. We are proud that over 60% of our workforce is female and our fair reward approach, introduced in 2014, ensures all our roles are externally benchmarked and paid fairly, regardless of gender. However, we have more men than women in our more senior and, therefore, more highly paid roles, meaning we have a gender pay gap. Further information on this is published on our website, which can be found at www.leedsbuildingsociety.co.uk/your-society/financial-information/gender-pay-gap/

Our second priority area is mental wellbeing, providing mental health awareness and support for our colleagues. Our mental health first aider training programme has commenced, which aims to have more colleagues able to provide support to others, across our organisation, by the end of 2018. Mental wellbeing training will also be provided for our people managers and colleagues, helping them to manage the complexities modern day life can bring.

Our colleague experience

We are proud to have highly engaged colleagues, with 96% responding to our annual Your Voice survey and achieving a record colleague engagement level of 80%. Our active Colleague Association provides a further route for us to hear our colleagues' views, all year round.

Colleague feedback is vital for us to hear, not just in terms of their own experience, but also to improve how we do things for our members. Our colleague suggestion process 'Let's be smart' allows everyone to contribute their ideas and some important changes have already been implemented.

Good communication is exceptionally important – so everyone understands our vision, the part they play, how we are progressing and how the work they do is recognised. All colleagues have quality time available with their managers throughout the year, to discuss their work and career priorities and their progress. There is a wide range of tools to ensure colleagues keep up-to-date, including monthly video blogs from Peter Hill, team meetings, a vibrant intranet site, a colleague newsletter and a colleague app, which helps bring everyone together by sharing information and providing recognition.

Career development

We have a strong learning culture, helping colleagues to develop their career with us. To keep pace with the changing expectations of our members and the transition to a more digital work experience, colleagues are encouraged to have a learning mindset and take advantage of an extensive provision of personal development, which includes opportunities to study for management and specialist qualifications. A range of secondments, internships, apprenticeship and graduate schemes also supports our talent requirements.

Reward

Our people strategy has a principle of fair reward, to ensure we offer the remuneration to attract and retain colleagues with the skills and experience we need. We are committed to paying the Living Wage and everyone participates in our bonus schemes, which are linked to the Society's financial success, improving customer experience and individual performance.

Karen Wint
Chief Operating Officer

27 February 2018

Non financial reporting

Formal environmental policies for the Society are currently being developed, and targets have been set for reducing the Society's impact on the environment. These are discussed in the Corporate Responsibility Report on pages 32 to 35.

The Society maintains the highest standards with regards to anti-bribery and corruption, and all colleagues undertake regular mandatory training on the required standards.

Additionally, the Society's Procurement and Supplier Management Policy is designed to ensure that the Society only enters into third party arrangements with suppliers who have policies and procedures in place to comply with applicable anti-bribery and corruption laws, including the Bribery Act 2010 and the Modern Slavery Act.

Approval of the Strategic Report

This Strategic Report has been approved by the Board of Directors and is signed on behalf of the Board.

Robin Litten
Chief Financial Officer

27 February 2018

Corporate Responsibility Report

Year ended
31 December 2017

Working in partnership to achieve more

In December 2016 we set out our responsible business strategy which contributes to our mission to help people save and have the home they want. This strategy also covers our wider commitments as an employer and a business that operates at the heart of communities across the UK.

To add even greater focus, we set ourselves twelve stretching targets to work towards between 2017 and the end of 2020. I'm pleased to say that we are making good progress; in fact we have achieved two of our targets within the first year of reporting, growing our TalkingPoint membership to 2,767 members who are actively involved and reducing our carbon emissions by 1,130,000 kg CO_2 between 2016 and 2017, which is the equivalent of taking 530 cars off the road for a year.

In the last year we have been focusing on building partnerships and working with likeminded organisations that share a similar ethos and can help us to go further.

For example, we have been working with the Carbon Trust to better measure, manage and reduce our carbon footprint. We are currently one of only two building societies to be awarded the Carbon Trust Standard for Carbon, which recognises our commitment to minimising our carbon footprint.

It also gives me great pride to announce that Leeds Building Society has selected Samaritans as its new charity partner. Feedback from our members played a key role in this decision and I hope you will support us with our target to raise £250,000 over the next two years to help those who are in emotional distress or struggling to cope.

I would like to extend my sincere thanks to all our members who have helped to shape our approach.

Richard Fearon
Chief Commercial Officer

27 February 2018

Our approach to responsible business

In December 2016 we set out our commitment to do what's right for our members, colleagues and communities, focusing on four broad areas:

- Money & Homes means helping our members save for the future and have the home they want;

- Members & Communities focuses on caring for members and the communities they live in;

- People & Places is about looking after the Society's colleagues and reducing the environmental impact in the places where the Society operates;

- Sustainable & Responsible means running the Society in the long term interest of our members.

Actions we've taken in 2017

All areas of our business have been taking action to ensure we're doing what is right for our members, colleagues and communities.

Money & Homes

The Society exists to help people save and have the home they want. Our products, our savings accounts and mortgages, are at the heart of this mission and we're committed to using them to make a positive difference. In 2017 twelve lending related product governance reviews were completed to ensure we stay on track.

Highlights:

- We helped a record 71,429 people to save for their future and 50,279 people have the home they want. We've achieved this through providing an attractive savings range and ensuring that our lending reflects differing and changing needs in society.
- We helped 12,944 first time buyers onto the housing ladder and, in total, our lending for affordable housing, including help to buy and right to buy schemes, increased by almost 10% from 2016 to £564 million in 2017.
- In 2017 the Society took the decision to increase the current minimum rate we pay all our members[1], which is currently 0.50%. This decision was taken before the Bank of England's rate change took effect.

[1] As long as the account is operated in line with the Terms and Conditions.

How we're performing against our four year plan.

We're on track to meet all 12 of our targets by the end of 2020.

We set ourselves twelve targets to reach between 2017 and the end of 2020, along with a commitment to report our progress against them annually. Our targets were selected to reflect the four themes in our Corporate Responsibility strategy and we will keep these under review to ensure they remain appropriate.

Money & Homes

Target 1

Help over **225,000** people save for their future

PROGRESS: ON TRACK

We're **31%** of the way towards reaching our target having supported **71,429** people to save for their future through our products.

Target 2

Help over **175,000** people have the home they want

PROGRESS: ON TRACK

We're **28%** of the way towards reaching our target having supported **50,279** people to have the home they want through our products.

Target 3

Help **30,000 First Time Buyers** into a home of their own

PROGRESS: ON TRACK

We're **43%** of the way towards reaching our target having supported **12,944** First Time Buyers to get onto the housing ladder.

People & Places

Target 4

Achieve above sector average **employee engagement** scores of over **70%**

PROGRESS: ON TRACK

Colleague engagement, as measured through our annual survey, increased from **78%** in 2016 to **80%** in 2017.

Target 5

Recycle all paper and use **100%** green tariff energy

PROGRESS: ON TRACK

All paper has been recycled and we have purchased **100%** renewable electricity from wind and hydro sources through our energy provider.

Target 6

Reduce carbon emissions within our business operations by **150,000 kg CO2**

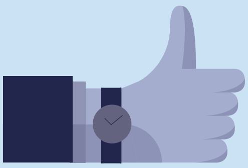
PROGRESS: ACHIEVED

Our carbon emissions decreased by **1,130,000 kg** CO2 between 2016 and 2017 equivalent to a **91%** reduction. [1]

Members & Communities

Target 7

Achieve high customer satisfaction scores of over **90%**



PROGRESS: ON TRACK

Our customer satisfaction score, as measured as an average over the year, was **91%** in 2017.

Target 8

Provide **8,000** colleague **volunteering** hours in the community

PROGRESS: ON TRACK

We're **58%** of the way towards reaching our target having invested over **4,700** hours into communities.

Target 9

Provide **£1.2m** to charities and the community through grants, donations and sponsorship

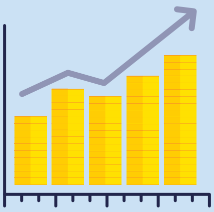
PROGRESS: ON TRACK

We're **28%** of the way towards reaching our target having donated over **£327,000** to charities and good causes.

Sustainable & Responsible

Target 10

Maintain financial strength and ability to grow through sufficient **CET 1 Capital** of over **14%**



PROGRESS: ON TRACK

Our CET 1 ratio was **14.5%** in 2017.

Target 11

Achieve better than the industry average for FOS upheld complaints

PROGRESS: ON TRACK

On average **22%** of complaints were upheld in favour of our customers between 1 January to 30 June 2017. The average for all financial businesses during this period was **36%**. [2]

Target 12

Increase the number of active members engaged on Talking Point to **2,500**

PROGRESS: ACHIEVED

2,767 of our members are actively engaged on TalkingPoint giving their views and helping to shape our decisions.

[1] For reporting purposes we have followed a 'market based' method that takes into account the procurement of renewable electricity from the market. Emissions have been calculated based on 2016 DEFRA emissions factors for both 2016 and 2017 to allow a like-for-like comparison to be made. [2] We are using the latest publically available data that was available from the Financial Ombudsman Service.

Members & Communities

Our members are at the heart of our decision making and over the last year we've focused on further improving the customer experience and doing even more to help members in vulnerable circumstances. We have also committed to new partnerships to make a meaningful contribution to the local communities our members and colleagues live and work in.

Highlights:

- We launched our partnership with parkrun with an aim to bring communities together. Through our funding we're aiming to ensure such a powerful movement stays free and accessible for everyone. In September 2017, we launched our parkrun Together month, where we encouraged parkrunners to bring a friend to their local event, in a bid to support community togetherness. As a result, we achieved an incredible total participation figure of 675,000 runners across the month.
- In 2017 we asked our colleagues and members which social issues mattered most to them and, based on this feedback, Samaritans was selected as our new charity partner. Over the next two years we will be aiming to raise £250,000 which will go towards helping those who are in emotional distress or are struggling to cope. We're excited to involve our members who will have many opportunities to support the partnership as it moves forward.
- Our colleague volunteering reached a record level in 2017 with over 50% of colleagues collectively investing 4,700 hours into over 160 projects up and down the UK. Since 2015 we've more than quadrupled the number of people using their seven hours volunteering allowance each year.
- Our Specialist Customer Support team have been in place for over a year now and, through a new partnership, we can provide adapted communications in braille, large print and audio CD. In most cases we can now send these materials to members that need them in 48 hours.
- We've taken steps to improve our bereavement process to support our customers when they're going through the most difficult of times, facing the loss of a loved one. We've increased the threshold at which proof of probate is required from £15,000 to £40,000, meaning many more customers can now close an account without needing probate. We've introduced a new bereavement guide that explains the steps customers need to take and the help we can offer.

About Samaritans

SAMARITANS

With more than 20,000 trained volunteers in 201 branches, Samaritans is available round the clock, every single day of the year, for anyone who is struggling to cope. In 2016 it responded to more than 5.7 million calls for help by phone, email, text, letter and face to face. Every six seconds someone contacts Samaritans. It provides a safe space to talk for anyone who needs it.

Changes to our Your Interest In Theirs scheme

From 2018 Samaritans and the Leeds Building Society Foundation, which makes donations to local charities across the UK, will be the new beneficiaries of the Your Interest in Theirs scheme, which enables members to donate up to 99p of interest each year to good causes.

People & Places

Delivering great customer experience relies on us having talented colleagues from all backgrounds. That's why in 2017 we have further increased our focus on both diversity and inclusion and have taken steps to refine our approach to wellbeing to focus on mental health. We also know that the places our members and colleagues use, such as branches, and the services we provide, have an environmental impact and we're doing all we can to minimise this.

Highlights:

- We achieved Investors in Diversity status in 2016 and since then we've trained all our colleagues in understanding diversity, inclusion and unconscious bias. More information on our approach to diversity and inclusion can be found on page 30.
- In 2017 we finished the refurbishment of our entire branch network, improving the experience for members and introducing energy efficient LED lighting as standard. We took steps to reduce the environmental impact of the changes at every step of the way. 101 counters, 166 desks and 3,120 sq. metres of carpet were recycled. All furniture not fit for re-use was chipped for bio-fuel or cattle bedding and less than 2% of waste was sent to landfill.

- Between 2016 and 2017 we reduced our carbon emissions by 91% or 1,130,000 kg CO_2 according to a 'market based' methodology that takes into account both the energy efficiency measures and the procurement of renewable electricity. That's the equivalent of taking 530 cars off the road for a year. In 2017 we also achieved the Carbon Trust Standard for Carbon. This reflects the progress we've made in measuring, managing and reducing our carbon emissions.

Carbon Trust

The Carbon Trust Standard for Carbon is a voluntary certification and mark of excellence that enables organisations to demonstrate their success in cutting their carbon footprint. It was developed by the Carbon Trust, an independent, expert partner of leading organisations around the world, helping them contribute to and benefit from a more sustainable future.

Using our office space for good

During a review of our property portfolio we took the decision to offer a local charity, Holbeck Elderly Aid (HEA), office space rent-free for five years. Contractors, working on a wider refurbishment of our branches, offered their time and labour for free to fit out and decorate the Holbeck premises. HEA is now using this as a base for preventing social isolation and loneliness of older people.

Sustainable & Responsible

Our Sustainable and Responsible theme means running our business in the long-term interests of our members. That means keeping our members' money safe and always operating to the highest levels of trust and integrity in everything we do, whether that's making considered lending decisions, or working with borrowers in financial difficulty. It also means listening to our members and their views.

Highlights:

- TalkingPoint continues to provide insight into what our members think, which helps to shape the business decisions that we make. There are now 2,767 members actively engaged on the platform and in 2017 they completed over 50 pieces of unique research. The topics we asked our members about included how Brexit could affect financial planning, how changes in Bank Base Rates may impact members and what makes good financial advice.
- The Society's CET1 ratio in 2017 was held above 14%. This is a key indicator showing the level of reserves available to the Society which in turn helps to ensure our business remains resilient.
- In 2017 we undertook research to better understand the responsible business issues that matter most to our members and our colleagues. Our continued financial stability, providing a great customer experience and having a diverse and inclusive workforce were seen as some of the most important aspects for us to continue to get right.

Governance around Corporate Responsibility:

Leeds Building Society is committed to doing the right thing in the right way and this is led from the top. We have a Corporate Responsibility Steering Group in place to drive action under our four Corporate Responsibility themes (see page 32). This is chaired by Richard Fearon, the Society's Chief Commercial Officer, and is made up of other senior representatives across the business. The Society's Board received two updates during 2017 to demonstrate progress against our Corporate Responsibility strategy.

Governance Chairman's Introduction

It is the responsibility of the Board, under my leadership, to maintain a high standard of corporate governance. Corporate governance is a key aspect of the framework through which the Board operates and underpins the Society's ability to deliver its strategy, grow the business and create long term value for members.

To ensure we can continue the Society's success into the future, we need to make sure we have the appropriate skills and expertise to run the business in the best long term interests of members.

The Society firmly believes in the benefits of a diverse Board membership and seeks a broad range of skills, experience, backgrounds and opinions.

Lynn McManus joined our Board in September 2017, bringing with her 20 years of experience in financial services. Lynn complements the existing Board, through her expertise and knowledge of finance, risk, human resources and communications.

I would like to thank Susan Cooklin, a non executive director who retired, in April 2017, after three years on the Board, following a promotion and increase in the commitment of her executive role at Network Rail. I would also like to thank my Board colleagues for their ongoing support, wisdom and challenge.

All directors are subject to election or re-election each year and a summary of their details can be found on pages 37 to 39. I ask you to support the nominations. Our Chief Executive Officer, Peter Hill, has continued to represent mortgage lenders as Chairman of the Council of Mortgage Lenders and, more recently, as a board member of the financial services trade association, UK Finance.

The Board's approach to corporate governance is based on the principles and provisions of the UK Corporate Governance Code (the Code) published by the Financial Reporting Council (FRC) in 2012, updated in July 2016.

The Society has continued to comply with the provisions of the Code in so far as they are relevant to a building society. A copy of the Code is available at www.frc.org.uk

This report sets out how the Board has operated throughout 2017 and applied the provisions of the Code.

Robin Ashton
Chairman

27 February 2018

Board of Directors

Key to Board Committees:

- A Audit Committee
- B Board Risk Committee
- M Models and Rating System Committee
- N Nominations Committee
- R Remuneration Committee
- ◯ Committee Chair

Robin Ashton
Chairman
N

Appointed: Chairman March 2013 and non executive director April 2011

Skills, competence and experience: Robin joined the Board as a non executive director in April 2011 and became Chairman in March 2013. As Chairman, he is responsible for overseeing the performance of the Leeds Building Society Board. He is a strong supporter of the building society sector and the mutual business model, which plays an important role in UK financial services.

Robin is a Chartered Accountant and spent his executive career in retail financial services. He has developed skills and experience, across a broad range of areas, in particular, credit, treasury, audit and accounting.

Other roles: Senior independent director of Shawbrook Group plc and its subsidiary Shawbrook Bank Ltd.

Peter Hill
Chief Executive Officer

Appointed: August 2011

Skills, competence and experience: Peter entered the mutual sector in 2001, joining the Society as a general manager before moving into operations and was appointed Operations Director in 2006. In 2011 he was appointed as Chief Executive Officer and is responsible for developing and proposing the Society's strategy, objectives and plans, as well as maintaining the Society's business model and culture.

Peter brings a breadth of experience and is approaching 40 years in retail financial services, covering a wide range of disciplines. He is an Associate of the Chartered Institute of Bankers and a fellow of the Royal Society of Arts.

Other roles: Director of UK Finance and member of the Mortgage Product Board.

R

Philippa Brown
Non executive director

Appointed: January 2013

Skills, competence and experience: Philippa joined the Board in January 2013, having over 25 years' experience within the marketing and digital sector, bringing a strong consumer and branding perspective to her role on the Board. She is Chief Executive Officer of a leading UK media agency. Philippa is also a member of the Society's Remuneration Committee.

Other roles: Chief Executive Officer of Omnicom Media Group UK Ltd, executive of OMD International Ltd and Phd International Ltd.

Richard Fearon
Chief Commercial Officer

Appointed: February 2016

Skills, competence and experience: Richard is responsible for the Society's strategy and direction across customer and digital, product development, as well as direct and intermediary distribution. He is Chair of the Corporate Responsibility Steering Group and Conduct Risk Committee.

After starting his career at Oliver Wyman & Company, he spent 10 years at Lloyds Banking Group in senior roles in the mortgages and savings businesses before joining the Society. Richard's experience has given him an excellent understanding of product development to meet customer needs, as well as strong strategic and commercial skills.

B A R

David Fisher

Non executive director

Appointed: March 2012

Skills, competence and experience: David joined the Board in 2012 and has nearly 30 years' experience within financial services, beginning his career with Halifax Building Society. As Chair of the Board Risk Committee, David's responsibilities include safeguarding the independence of the Compliance and Risk Functions. David is also a member of the Society's Remuneration Committee and Audit Committee.

Prior to joining the Society, he was Chief Executive of Sainsbury's Bank and he also undertakes a number of advisory roles. During his career, he has developed a wealth of knowledge in retail financial services and has a strong understanding of risk management, pensions and human resources.

M

Andrew Greenwood

Chief Risk Officer

Appointed: January 2015

Skills, competence and experience: Andrew joined the Board as Chief Risk Officer in 2015. He started his career as a solicitor in private practice and has worked for the Society since 1998 in a variety of legal, compliance and risk-focused roles. He has developed extensive experience of working in a highly regulated environment. His skills and experience enable him to lead the Risk Division, which comprises a number of specialist teams.

Andrew is responsible for the overall management of the risk control framework of the Society, which includes co-ordinating and managing principal risks and risk appetite.

He reports directly to the Board Risk Committee and attends all of the Society's management risk committees.

A B

Gareth Hoskin

Non executive director

Appointed: November 2015

Skills, competence and experience: Gareth has gained extensive experience during his 30 year career in UK and international financial services; as a director of Legal & General plc and Chief Executive Officer of its International Division and previously as a Chartered Accountant at Price Waterhouse.

As Chair of the Audit Committee, his responsibilities include safeguarding the independence of the Internal Audit Function and he is the Society's Whistleblowers' Champion.

Other roles: Non executive director, trustee and Audit Committee Chair of Diabetes UK Ltd and advisor to the Board of Green Park Partners Ltd.

M B

John Hunt

Non executive director

Appointed: April 2015

Skills, competence and experience: John began his banking career with Yorkshire Bank in Leeds. He has held senior posts in a number of major UK and international banks and was a founder member of the Global Credit Data Consortium.

His areas of particular specialism fall within credit and treasury risk management and he is Chair of the Models and Rating System Committee.

Other roles: Director of JCH Associates Ltd.

B M N

Philip Jenks

Non executive director

Appointed: March 2012

Skills, competence and experience: Philip has over 40 years' experience in the financial services and mortgage industries. He has worked as a consultant for organisations including the Government on housing related projects. Philip has developed a strong understanding in these and other specialist areas including credit, technology and conduct risk management.

Other roles: Deputy Chairman of Broadlands Finance Ltd, Charter Court Financial Services Group and its subsidiaries.

M

Robin Litten

Chief Financial Officer

Appointed: January 2012

Skills, competence and experience: Robin joined the Society in 2012 having spent the previous 15 years in the mutual building society sector. He has held senior roles at Barclays Bank, Skipton and Scarborough Building Societies.

Robin plays a key role in ensuring the Society remains financially secure and is able to fund continuing growth and investment for the benefit of its members. He leads the Society's Finance, Treasury and Strategy Functions and is Chair of the Assets and Liabilities Committee.

A

Lynn McManus

Non executive director

Appointed: September 2017

Skills, competence and experience: Lynn joined the Board in September 2017 bringing over 20 years' experience within financial services.

She has worked within finance, risk, human resources and communications. Her most recent role was at Clydesdale Bank, where she was a member of the executive team.
Lynn is a Chartered Management Accountant.

R A N

Les Platts

Vice Chairman, Senior Independent Director and non executive director

Appointed: Vice Chairman and Senior Independent Director March 2014 and non executive director October 2010

Skills, competence and experience: Les is a Chartered Accountant and was a Senior Partner for Deloitte in Leeds, where he developed a deep understanding of the auditing and accounting arena. As Chair of the Remuneration Committee, he is responsible for overseeing the development and implementation of the Society's remuneration policies and practices. Through his career, Les has also developed a strong understanding in the fields of enterprise risk and human resources.

Other roles: Chairman of A J Bell Holdings Ltd and Honorary Treasurer of Lancashire County Cricket Club.

Karen Wint

Chief Operating Officer

Appointed: November 2012

Skills, competence and experience: Karen was appointed to the Board in 2012 with over 30 years of experience within financial services. She is a Chartered Banker and has held senior roles within the Commercial and Operations Divisions.

As Chief Operating Officer, she is responsible for ensuring that the Society has the right people, processes and technology in place to continue to deliver great service and value to its members. That includes continuing to change and update how things are done to meet customer expectations in a rapidly changing world. Karen is Chair of the Operational and Regulatory Risk Committee and is the accountable executive for meeting the Society's targets under the Women in Finance Charter.

Corporate Governance Report

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The role of the Board

The Board considers good corporate governance and a strong risk management framework essential to the long term success and viability of the Society. The Board is ultimately responsible for the business strategy and financial soundness of the Society and for establishing a governance framework and practices to facilitate its effectiveness in decision making and good governance. Management performance is assessed to ensure that adequate skills and resources exist to deliver strategy, including projects which will help the Society to innovate and evolve for the benefit of its members.

The Board sets the tone from the top and provides oversight of management's role in establishing and maintaining its culture and values. This includes clearly setting out the key responsibilities of the Board and the Senior Leadership Team. Distinct job descriptions exist for all Board-related roles and details can be found later in this report.

A formal schedule specifies those matters reserved for approval by the Board and these include: the establishment of and changes to the Society's strategy; the Corporate Plan and budgets; proposals for the appointment, re-appointment or removal of the external auditor; annual review of the effectiveness of the Society's systems of internal control; the Society's capital and liquidity requirements and annual approval of the Society's risk appetite.

The Board operates through meetings of the full Board, as often as is necessary for the proper conduct of business. This comprised 10 meetings in 2017 with two additional meetings dedicated to planning and strategy. A comprehensive and timely set of papers are provided for each meeting, which are designed to provide clear information to assist the Board with its deliberations and decision making. Details of the areas considered by the Board can be found below.

Certain responsibilities are delegated to a number of Board committees, each one having clear and detailed Terms of Reference. The Board committees and their responsibilities are described in more detail on pages 42 to 44.

Powers are delegated from the Board to the Chief Executive Officer (CEO) and through him to the Senior Leadership Team, via documented delegated authorities. These set out the responsibilities, decision-making and approval powers of managers at different levels of the Society and are reviewed and approved by the Board annually.

Board activity

The table below shows the key areas of Board activity during the year:

Strategy	• Monthly updates from the Chief Executive Officer on performance against corporate objectives, a risk overview, key business priorities and a summary of the economic outlook • Strategy and planning conferences • Approval of, and monitoring, performance against the Corporate Plan and strategic objectives, including a review of the Corporate Plan growth assumptions • Strategic analysis of 'horizon' based themes, such as competitor strategies and Open Banking • Review and approval of the Corporate Responsibility, brand and savings strategies • Business change and project activity updates • Reviews of the competitive and market outlook • Reviews of the economic environment, including the Monetary Policy Committee's interest rate decisions • Review of the Society's operating model and future developments • Brexit contingency planning • Review of the pricing methodology and key assumptions
Members	• Monthly updates from the Chief Commercial Officer on mortgage and savings business performance and customer complaints • Approval of the Annual General Meeting resolutions, plans and logistics • Quarterly customer satisfaction and research reports • A mutuality review • Updates on customer centricity • Review of customer related management information • Sponsorship update • Vulnerable customer update

Risk	• Monthly updates from the Chief Risk Officer on performance against corporate objectives, a risk overview and key business priorities • Annual review and approval of risk appetite • Annual review of systems and controls across the three lines of defence • Annual Money Laundering Reporting Officer's report including approval of the Prevention of Financial Crime Policy • Approval of capital issuances and annual update of the covered bonds and Euro Medium Term Note (EMTN) programmes • Approval of the ICAAP • Approval of the ILAAP • Approval of the Recovery and Resolution Plan (including continuity of access confirmation) • Approval of the Responsible Lending Policy and the Debt Management Policy • Annual review of the Treasury limits and policies • Cyber security strategy and training • Update on technology strategy • Update on the Society's progress against the General Data Protection Regulation • Minutes and updates from the Board Risk Committee, including the quarterly Chief Risk Officer's report • Implementing the approach to the PRA Statement 20/15 on 'Supervising Building Societies' Treasury and Lending Activities'
Performance	• Monthly updates from the Chief Financial Officer on financial performance, capital, liquidity and financial risk • Monthly updates from the Chief Operating Officer on the change portfolio, IT resilience and customer service operations • Approval of the Society's interim and full year financial results • Quarterly forecast reviews • Reports and minutes from the Models and Rating System Committee
People	• Monthly updates from the Chief Operating Officer on people matters • Appointment and re-appointment of non executive directors • Chairman's appraisal • Division of responsibilities between the Chief Executive Officer and the Chairman • Succession planning and talent management • Non executive pay review • Responsibility maps for the Senior Managers Regime • Review and approval of the Remuneration Policy • Reports and minutes from the Remuneration Committee • Annual report on the implementation of the Speak Up Policy • Annual review and approval of the Modern Slavery Transparency Statement • Approval of the directors' indemnity insurance • Review of progress against the people strategy
Governance	• Board effectiveness review • Board culture progress review • Regulatory updates on new and emerging matters • Oversight of actions agreed with the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) • Approval of the Delegated Authorities Manual • Annual review and approval of potential conflicts of interest • Reports and minutes from the Audit Committee • Reports and minutes from the Nominations Committee • Private meetings between the Chairman and non executive directors, without the executives present

Board and executive management committees

The Board delegates certain duties to a number of Board committees so that they can be discussed and considered in more detail. Board members are appointed to those committees most relevant to their skills and areas of expertise. The Chair of each committee is responsible for ensuring receipt of accurate, timely and clear information to assist with their deliberations and decision making. Each committee has its own clearly defined Terms of Reference. Board committees have been established in line with the provisions of the Code.

There are three executive management committees to support the CEO in managing the business: the Executive Committee (ExCo), the Management Committee (ManCo) and the Transformation Committee (TranCo). The executive management committees are also supported by a number of role focused management committees.

The Board committee and executive management governance structure is outlined below:

Board

The Board

The Board is accountable to the members of the Society and is responsible for providing overall leadership of the Society and a solid framework in which to operate.

The Board is collectively responsible for:

- safeguarding members' interests;
- monitoring progress by management in delivering the Society's strategy and business performance;
- ensuring robust risk management systems and robust financial and internal controls are in place;
- the Society's risk appetite;
- ensuring that the Society operates within its rules (as amended from time to time), rules and guidance from the PRA and the FCA and all applicable laws; and
- leading, developing and implementing the Society's culture.

Board committees

Board Risk Committee (BRC)

Reviews the Society's exposure to risk and oversees the Risk Management Framework to ensure that it is appropriate to mitigate current and prospective risks; oversees risk related reviews; develops strategic risk appetite and the Society's ICAAP, ILAAP and RRP for Board approval.

Audit Committee

Monitors the integrity of external financial reporting; reviews the effectiveness of the systems of internal control and assesses the effectiveness, performance and independence of the Internal Audit Function and the external auditor.

Nominations Committee (NomCo)

Reviews the structure, size, diversity and composition of the Board; oversees succession planning and identifies candidates to fill Board vacancies; responsible for ensuring compliance with good corporate governance.

Remuneration Committee (RemCo)

Ensures that the remuneration policies, principles and practices support the long term interests of the Society and are appropriate to attract, reward and retain talented executive directors. The Committee also ensures that performance related elements of remuneration are transparent, stretching and rigorously applied, having regard to the risk appetite, member views and other stakeholders.

Models and Rating System Committee (MRSC)

Oversees the development and performance of the Society's rating system and reviews its performance against prudential regulation.

Executive management committees

The Executive Committee (ExCo)

The primary purpose of the ExCo is to enable the executive directors to manage the Society in a co-ordinated way, taking a broad view of key issues and priorities. The ExCo is required to monitor performance against corporate objectives and a balanced scorecard to facilitate early identification of divergence from plan and agree and monitor remedial action, as appropriate. The ExCo is responsible for formulation of strategy for approval by the Board and, in particular, has ownership of the people strategy and the customer strategy. The ExCo is supported by the Management Committee (ManCo), the Pricing Working Group, the Transformation Committee, the Culture Working Group and the Stress Testing Working Group. The ExCo does not have a formal role in the Society's risk governance structure other than in the context of strategy and planning.

The Management Committee (ManCo)

The primary purpose of the ManCo is to enable the Senior Leadership Team to manage the Society in a co-ordinated way, providing a broad view on key issues and priorities. In support of the ExCo, the ManCo is required to monitor performance against corporate objectives and the balanced scorecard to facilitate early identification of divergence from plan and agree and monitor remedial action, as appropriate. Again, in support of the ExCo, the ManCo provides input to the formulation of strategy, with a particular emphasis on the people strategy and the customer strategy. Working alongside the TranCo and the Portfolio Management Working Group, ManCo assists in the co-ordination and implementation of strategic change programmes.

The Transformation Committee (TranCo)

The primary purpose of the TranCo is to provide oversight of the Society's change portfolio (focusing on the most critical projects) and ensure it is aligned to the overall strategic vision. TranCo is supported by the Portfolio Management Working Group which is responsible for governing the formulation, control and management of the overall change portfolio and providing oversight of small change activity and enhancements.

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Board Risk Committee (BRC)

The Chair of the BRC is David Fisher and the other members of the Committee during 2017 were Philip Jenks, Gareth Hoskin and John Hunt.

The BRC is supported by four management committees in the delivery of its extensive responsibilities. The management committees are: the Assets and Liabilities Committee, Credit Committee, Conduct Risk Committee and the Operational and Regulatory Risk Committee.

Further details on the Risk Management Framework, together with details of how these risks are managed, are set out in the Board Risk Committee Report on pages 54 to 58 and in the Notes to the Accounts. Details of the principal risks faced by the Society are set out in the Strategic Report on pages 14 to 19.

Audit Committee

The Chair of the Audit Committee is Gareth Hoskin and the other members of the Committee during 2017 were Susan Cooklin, Les Platts, David Fisher and Lynn McManus.

Further details on the work of this committee can be found on pages 60 to 66.

Nominations Committee (NomCo)

The Chair of the NomCo is Robin Ashton and the other members of the Committee during 2017 were Les Platts and Philip Jenks.

In summary, the key responsibilities and deliverables of the committee in 2017 were:

- a review of the composition of the Board and Board committees;
- the recruitment and selection process leading to the appointment of a new non executive director;
- a review of non executive director induction and training;
- annual review of the required capabilities and the job descriptions for the roles captured by the Senior Managers Regime;
- annual review of the Senior Manager and Certification Regime Selection Policy;
- oversight of the annual appraisal of directors;
- planning and preparation for the Board effectiveness review;
- a review of the Board Conflicts of Interest Register and approval of the Standard;
- a review of the Competency Matrix and Board Succession Plan;
- senior leadership talent and succession planning;
- annual review of compliance with the Corporate Governance Code;
- a review of matters reserved for the Board and the division of responsibilities between the Chairman and Chief Executive Officer;
- annual review of the Diversity and Inclusion Policy; and
- a review of Board training and development plans.

Details on the work of this committee can be found throughout this report.

Remuneration Committee (RemCo)

The Chair of the RemCo is Les Platts and the other members of the Committee during 2017 were David Fisher and Philippa Brown.

Further information can be found in the Directors' Remuneration Report on pages 68 to 81.

Models and Rating System Committee (MRSC)

The Chair of the MRSC is John Hunt. The other non executive member of the Committee during 2017 was Philip Jenks and other director members were Robin Litten and Andrew Greenwood.

The MRSC supports the Board in fulfilling its oversight responsibilities for the ratings system and general modelling. These responsibilities include overseeing the development of the ratings system and its performance, in addition to compliance with prudential regulatory requirements.

Further information can be found in the Board Risk Committee Report on page 58.

Terms of Reference

The schedule of matters reserved for the Board and the Terms of Reference for the committees are updated on an annual basis (or more frequently, if required) and are available to view on the Society's website: www.leedsbuildingsociety.co.uk/your-society/about-us/ or by writing to the Secretary at Leeds Building Society, 105 Albion Street, Leeds LS1 5AS.

Board and Board committee membership attendance record

The table below shows the attendance of all directors at scheduled Board meetings and attendance of those who are members of the Board committees at committee meetings held during the year.

Director	Board	Audit	Board Risk	Nominations	Remuneration	Models and Rating System
Robin Ashton	10 (10)			4 (4)		
Philippa Brown	9 (10)				3 (4)	
Susan Cooklin**	2 (3)					
Richard Fearon*	10 (10)					
David Fisher	10 (10)	4 (4)	8 (8)		4 (4)	
Andrew Greenwood*	10 (10)					7 (7)
Peter Hill*	10 (10)					
Gareth Hoskin	10 (10)	6 (6)	8 (8)			
John Hunt	9 (10)		7 (8)			6 (7)
Philip Jenks	9 (10)		7 (8)	4 (4)		6 (7)
Robin Litten*	10 (10)					7 (7)
Lynn McManus	3 (3)	2 (2)				
Les Platts	10 (10)	6 (6)		4 (4)	4 (4)	
Karen Wint *	10 (10)					

*executive directors/chief officers

** retired 6 April 2017

Board roles

The roles of the Chairman and Chief Executive Officer are distinct and are held by different people. A review of the division of their responsibilities takes place annually by the NomCo, to ensure they remain separate and well defined.

The Chairman's principal role is to lead the Board. He is not involved in the day-to-day management of the Society. The CEO's primary role is to focus on the running of the Society and implementing strategy.

The role of the non executive directors is to bring independent judgement and perspective to Board debates and decisions and to constructively challenge the work and proposals of the Senior Leadership Team, applying the highest standards of conduct, integrity and probity.

It is anticipated that after induction, non executive directors may be required to commit, on average, up to 36 days per annum in the discharge of their duties.

The main purpose of the non executive role is:

Strategy	To constructively challenge and help develop proposals on strategy, ensuring the fair treatment of customers and positive outcomes.
Risk	To set the Society's risk appetite and to ensure that the integrity of financial information and controls are robust and fit for purpose.
Performance	To approve the Corporate Plan, monitor performance and challenge the executive team to deliver against plan objectives.
People	To have oversight of the culture, reward and talent management strategies while ensuring management performance achieves the required corporate goals.
Governance	To discharge allocated PRA / FCA Prescribed Responsibilities and / or FCA Business Activities via the Society's management forums, in line with the Society's Risk Management Framework.
Member	To ensure the fair treatment of members.

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Continued

Distinct job descriptions exist for all Board-related roles and the table below highlights the key accountabilities of these roles:

Role	Key accountabilities
Chairman	• The effective running of the Board and guardian of the Board's decision making process. • To support and advise the Chief Executive Officer in the development of strategy, as well as more broadly. • To ensure that the Board takes responsibility for the successful current and sustainable long term performance of the Society. • To lead the development of the Society's culture by the governing body as a whole. • To ensure that the Board receives accurate, timely and clear information. • To take the lead in providing a properly constructed induction programme for new directors and in identifying and seeking to meet the development needs both of individual directors and of the Board as a whole. • To ensure the effectiveness of the Board, its committees, and individual directors is formally and rigorously evaluated, at least once a year. • To promote the highest standards of integrity, probity and corporate governance.
Chief Executive Officer	• To propose and develop the Society's strategy, objectives and Corporate Plan. • To ensure the Society operates an adequate system of control through the application of a three lines of defence model. • To ensure that prudential, conduct and operational risks are adequately controlled. • To deliver a balanced business performance across a wide range of scorecard measures to ensure the achievement of short term Corporate Plan objectives, whilst building long term sustainable performance. • To lead the executive team and, by implication, all colleagues within the Society. • To set the tone in respect of the Society's culture and to coalesce all colleagues around the Society's vision, strategy and values. • Responsible for all executive management matters affecting the Society. Whilst the Chief Internal Auditor reports to the Chair of the Audit Committee, there is a subsidiary reporting line to the Chief Executive Officer. • To discharge the allocated PRA / FCA Prescribed Responsibilities and FCA Business Activities via the Society's management forums in line with the Society's Risk Management Framework.
Senior Independent Director/Vice Chairman	• To work closely with the Chairman, acting as a sounding board and providing support. • To act as an intermediary for other directors as and when necessary. • Be available to key stakeholders and other non executives to address any concerns or issues they feel have not been adequately dealt with through the usual channels of communication. • To meet at least annually with the non executives to lead the assessment of the Chairman's performance and to carry out succession planning for the Chairman's role. • To deputise for the Chairman.
Chair of Audit Committee	• To monitor the integrity of the financial statements of the Society and any formal announcements relating to financial performance, reviewing significant financial reporting judgements contained therein. • To review the adequacy and effectiveness of the Society's internal controls and risk management systems. • To monitor and review the independence, integrity, skills, resourcing and performance of the Internal Audit Function. • To make recommendations to the Board, for the appointment / re-appointment and remuneration of the external auditor and review and monitor their independence and objectivity. • To undertake the role of Whistleblowers' Champion.
Chair of: BRC, NomCo, RemCo, MRSC	• To ensure compliance with and delivery of good standards of governance, in accordance with the committee terms of reference, ensuring the committee provides effective independent oversight and challenge of executive decisions by fostering open and inclusive discussions.

Secretary

Katherine Tong is the Society's Secretary. Katherine is also the Director of Legal and Compliance and has worked for the Society for 17 years. She has been employed in a number of business areas and has a wealth of experience in compliance and risk management. Katherine is supported in her role as Secretary by the Secretariat team.

Effectiveness

Board composition

The Board comprises 13 directors, of whom five are executive directors and eight are independent non executive directors. The size and composition of the Board is reviewed continually throughout the year and is considered at least annually by the NomCo. This ensures that succession planning is adequately addressed, promoting the continual refresh of skills and experience on the Board.

The current composition of the Board complies with provision B.1.2 of the Code, which requires at least half of the Board, excluding the Chairman, to be made up of independent non executive directors. The Board considers that all non executive directors are independent in character and judgement.

The Board's annual review of potential conflicts of interest (further details of which can be found on page 49) did not identify any relationship or conflict which would impair a non executive director's ability to meet the criteria set out in the Code.

The Board considers that the current mix of directors' skills, experience, background and opinions complement each other and provide an appropriate balance, which helps ensure members' interests are protected and the Society has appropriate leadership and direction.

Where appropriate, all directors have access to the advice and services of the Secretary and, if required to fulfil their roles and responsibilities, to independent professional advice, at the Society's expense.

Non executive directors are appointed for a three year period. They are usually expected to serve two terms. These terms are subject to ongoing performance evaluations and to annual re-election by the members of the Society. They may also be proposed for a third term, up to a maximum of a further three years. Robin Ashton has been a non executive director since April 2011 and the Society's Chairman since March 2013. Following a rigorous review and taking into account his depth of experience and skills, NomCo recommended that the Board extend his directorship until April 2020. The Board approved the recommendation.

On 6 January 2017, the Society announced the resignation of Susan Cooklin, a Society non executive director, with effect from 6 April 2017. Susan decided to leave following a promotion and increase in the commitment of her executive role at Network Rail. She served three years on the Board. Further details of the selection and appointment process for the vacancy created by Susan's resignation can be found below.

Succession planning

The NomCo regularly considers succession planning and is responsible for the appointment of new directors and members of the Senior Leadership Team, making recommendations to the Board, as appropriate.

The NomCo considers the size and composition of the Board and reviews the mix of skills (using a skills matrix), experience, background and opinions of the existing directors to ensure that the Board continues to have the right balance to carry out its duties. The NomCo also reviews the length of service of each non executive director and the impact on Board committee membership, when they are nearing the end of their term of appointment. The NomCo will then determine which skills and expertise will be required when recruiting a new candidate.

Appointments to the Board

The Board appointed Warren Partners to assist in the search for a replacement for Susan Cooklin. Warren Partners follow the executive search firms' voluntary Code of Conduct, an industry standard code to redress gender balance and promote best practice. The search and appointment process was comprehensive and involved open advertising, long and short listing, as well as a range of interviews, tools and techniques to assess candidate suitability.

In order to be successful, all directors must meet the tests of fitness and propriety prescribed by the FCA and PRA and for certain roles must be approved by both regulators. In addition, they must be elected to the Board by the members at the first opportunity following initial appointment.

The Board elects its Chair and Vice Chair annually at the Board meeting immediately following the AGM.

In accordance with the Society's rules, members are entitled to nominate candidates for election to the Board.

Copies of all non executive directors' letters of appointment are available on request from the Society's Secretary.

Corporate Governance Report

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Board diversity

To reflect the importance placed on gender diversity, the Board has agreed a target of 33% for female representation on the Board, by 2021. Currently, three members of the Board are female representing 23% of the total Board membership. Within the Society's top three levels of management, the current population is 92, of which 32 are female. This equates to 35% female representation in this group.

The Society firmly believes in the benefits of a diverse Board membership and promotes an inclusive culture across the organisation, in line with the Society's values.

Leeds Building Society firmly believes in the importance of a diverse Board membership, in its broadest sense and promotes an inclusive culture across the organisation, in line with the Society's values. We believe the diversity of skills, experience, backgrounds, opinions and other distinctions including gender and race strengthens the capability of the Board and, therefore, the effectiveness of its independence, judgement and decision making.

All Board appointments will be based on merit against objective criteria, the skills and experience of the Board as a whole and with regard to the benefits of diversity.

The NomCo reviews and assesses Board composition on behalf of the Board on an annual basis and recommends the appointment of directors. The Committee also oversees the conduct of the annual review of Board effectiveness.

The NomCo will agree, annually, the measureable objectives for Board diversity and recommend them to the Board for adoption. Currently, the objectives are to:

- proactively aim for, and sustain, female representation of 33%, both on the Board and in the top three layers of our Senior Management Team (excluding the Board) by 2021;
- only engage executive search firms which have signed up to the voluntary Code of Conduct for gender diversity and best practice. External advertising is to be considered as part of the attraction methods utilised; and
- provide enhanced disclosure on the Board appointment process and the consideration of diversity as part of the Board evaluation process.

The NomCo will report annually in the corporate governance section of the Society's Annual Report and Accounts on the agreed objectives and the progress made against these objectives, as well as other initiatives taking place which promote gender and other forms of diversity.

The Society is a signatory to the Women in Finance Charter, demonstrating commitment in this area and also believe it is important to consider elements of diversity beyond gender and have developed a broad ranging diversity and inclusion strategy.

The Society has a dedicated diversity page on its website, which can be found at www.leedsbuildingsociety.co.uk/your-society/financial-information/diversity/

Gender pay

The Society welcomes the move to drive the fairness of pay for women, having introduced its own 'fair reward' approach in 2014, which helps to determine salaries objectively for all colleagues.

The phrase 'gender pay gap' is used to describe the difference in average hourly pay for male colleagues compared to female colleagues (as opposed to 'equal pay' which relates to a male and female doing the same work and potentially being paid differently).

The Society is proud that over 60% of its workforce is female. However, there are more men than women in our more senior and, therefore, more highly paid roles, meaning there is a gender pay gap. Further information has been published on our website, which can be found at www.leedsbuildingsociety.co.uk/your-society/financial-information/gender-pay-gap/

Gender diversity is taken seriously and a priority in the Society's diversity and inclusion strategy is to consider how the Society can increase the number of females in senior roles, developing talent for the future and removing any barriers to their career.

Directors' induction, development and individual performance evaluation

On appointment, all new directors receive a detailed induction programme, which is tailored to their individual requirements and based on their skills and expertise. The programme is also cognisant of the role they will play within the committee and governance structure.

In order to maintain continuous professional development, all directors also have an individual personal development plan, which is monitored, reviewed and refreshed during their annual evaluation.

Ongoing professional development is essential to enable directors to be sufficiently and appropriately informed about the Society, its values and culture, its business and objectives, the regulatory framework and the market in which it operates. Having a strong command of issues relevant to prudential and conduct risk management systems is also essential and will inform Board or committee discussions and decisions.

The performance of individual non executive directors is evaluated annually by the Chairman. The Board evaluates the Chairman's own performance at a meeting when he is not present and feedback is provided to him by the Senior Independent Director.

Executive directors, including the Chief Executive Officer, are evaluated annually within the framework for all colleagues of the Society and by the RemCo in terms of remuneration and any bonus payments.

Board effectiveness

The Board undertakes an annual evaluation of its performance and effectiveness, which is facilitated by an external firm at least every three years. An externally facilitated review was last held in 2015. In April 2017, the Chairman and Senior Independent Director led the internal evaluation process. The outcome of the review concluded that the Board, including its members and committees, are operating effectively and no significant areas for remedial action were identified.

All Board committees also evaluate their own performance and effectiveness annually. This process serves to identify any areas where non executive directors or committees require further training and development in order to discharge their duties effectively.

Conflicts of interest

All directors have a statutory duty to avoid any actual or potential conflicts of interest.

The Board has a Conflicts of Interest Policy which sets out the procedures for declaring and, if appropriate, authorising any real or potential conflicts of interest, should they arise. The policy requires that any other positions which a director wishes to take up should first be referred to the Board for consideration, in terms of any potential conflict of interest and time commitment.

The Secretary maintains a detailed register of any conflicts of interest and this is submitted annually to the Board for review. The Board has considered the current external appointments of all directors which may give rise to a situational conflict and has authorised potential conflicts, where appropriate. The Board considers that neither the Chairman nor any director had a material conflict of interest or any significant new commitments to declare, which would impact the effective discharge of their responsibilities, during the year ended 31 December 2017.

The NomCo considers that all directors comply with Article 91 of Capital Requirements Directive IV, which came into effect in July 2014, and have sufficient time to discharge their duties at the Society and do not hold more than the prescribed number of directorships.

Accountability

Risk management and internal control

The Board recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of member and Society assets. It is the responsibility of management to design, operate and monitor internal controls which adhere to the Board's policies on risk and control.

The Society operates a Risk Management Framework (RMF) which encourages a culture of sound risk management and internal control. The RMF facilitates robust risk assessment and requires the effectiveness of risk management and internal control systems to be monitored and reviewed. In 2017, the Society progressed aspirations to use its own estimated risk parameters for the purpose of calculating regulatory capital. This is known as the internal ratings-based (IRB) approach to capital requirements for credit risk.

Corporate Governance Report

Continued

The Board is responsible for reviewing the ongoing effectiveness of the systems of internal control and does so through regular reports and presentations to the Board as well as through the supporting Board committees; in particular the Audit Committee and the Board Risk Committee.

Further details of the Society's RMF can be found on page 54. Details of the role and responsibilities of the Audit Committee can be found on pages 60 to 66.

The Board is satisfied with the effectiveness of the governance processes, which have operated under the RMF and that during 2017 the Society maintained an adequate system of internal control, covering all material controls including financial, operational and compliance controls.

Financial reporting

Following recommendation from the Audit Committee and after making appropriate enquiries and undertaking reviews of internal reports, as well as following completion of the external audit, the directors consider the Annual Report and Accounts to be fair, balanced and understandable when taken as a whole. It provides the necessary information for members to assess the Society's position, performance, business model and strategy. Details on how this assessment was determined can be found on page 63.

The directors' statement on going concern, why it is considered appropriate to adopt and how this was arrived at, can be found in the Directors' Report on pages 52 to 53. The assessment of the Society's prospects and viability (and the period to which it pertains) can be found in the longer term Viability Statement, in the Strategic Report, on pages 20 to 21.

Remuneration

The annual report on remuneration and details of the Society's Remuneration Policy can be found in the Directors' Remuneration Report on pages 68 to 81.

Relations with members and other investors

The Society is a member owned mutual organisation and the views of savers and borrowers are very important. Feedback on any aspect of the Society's business activities is encouraged in a number of ways:

Independent market research

Quarterly customer satisfaction surveys are conducted to understand, and act upon, customer feedback on the level of service they have received. These reports are submitted to the Board and used by management as a catalyst for service evaluation and improvement.

TalkingPoint

The Society believes that it is important to know what really matters to members to help make the Society, and its products and services even better. Through TalkingPoint, the Society's online member forum, members have the chance to tell the Society what they think. It is an opportunity to give feedback on a wide range of subjects, from the Society itself to new products and services.

The forum has continued to grow since its launch in 2015, with over two thirds of registered members actively taking part in research over the last three months alone, helping the Society to better understand the needs of customers.

Not only are members encouraged to engage with the Society, they are also encouraged to talk to each other. A number of forums and research activities have been created where members can exchange opinions of specific circumstances. Some recent research conducted with TalkingPoint members includes;

- views and opinions on the Society's 2017 Annual General Meeting (AGM) and ideas for how the 2018 AGM can be improved;
- a survey to understand what information members want including in communications to them and for which accounts;
- a review of how the Society uses social media, asking members what they want to receive and the ways in which they expect to receive it;
- a two day event, where members discussed their experiences with the withdrawal and deposit processes across multiple channels;
- an eight week research project understanding the customer impact of all aspects of a mortgage maturity, including how to select their next product (even if it is not with the Society); and
- a mini poll for member payment preferences.

More information can be found on the Society's website at www.leedsbuildingsociety.co.uk/your-society.

Complaints process

The Society's commitment to its customers is enshrined in its mission statement, which is "To help people to save and have the home they want. We will continually adapt to anticipate our members' changing needs and by doing the things we do well, we will help our members get on with life."

The Society aims to deliver service and products that meets the needs and expectations of its members. Sometimes mistakes and misunderstanding do occur. Should a customer ever feel their expectations have not been met then every effort is made to ensure it is investigated fully and resolved as soon as possible.

The Annual General Meeting (AGM)
The AGM is a key event for members to have their say on how the Society is run. The next meeting will be held on Thursday 12 April 2018 at 11am at the Howard Assembly Room, Leeds LS1 6NZ. All eligible members will be sent the Notice of the AGM, a proxy voting form and a member magazine which includes the Summary Financial Statement, along with details of how to contact the Society.

Members are asked to vote on a number of resolutions, including the Society's Annual Report and Accounts, the re-election of the external auditor, the Directors' Remuneration Report and the election and re-election of directors.

Members can vote in person at the AGM, in one of the Society's branches, by post or online. Members are encouraged to personally attend and join the Society's directors, who make themselves available to answer questions, both during and after the meeting. The results of the vote are published on the Society's website and via a regulatory news service.

Building on the 2017 approach, members will again be asked to join TalkingPoint to provide feedback on their voting experience. This helps the Society to improve customer experience and to understand how members prefer to vote, and the information they require.

Further information on member engagement can be found in the Corporate Responsibility Report on pages 32 to 35.

Relations with other investors
The Society's Treasury Function holds meetings with institutional investors after the half year and full year results have been announced. Regular meetings are also held on an ongoing basis, and regular dialogue is maintained with credit rating agencies.

Approved by the Board of Directors and signed on behalf on the Board.

Robin Ashton
Chairman

27 February 2018

Directors' Report

Year ended
31 December 2017

The directors have pleasure in presenting their Annual Report, together with the Annual Accounts and Annual Business Statement, for the year ended 31 December 2017.

Information on the Society's vision, strategy and business performance is provided in the Strategic Report on pages 2 to 31.

Profits and capital

The profit and capital position is set out on pages 22 to 29 of the Strategic Report.

Principal risks and uncertainties

The principal risks and uncertainties faced by the Society (and its approach to managing them) are set out in the Strategic Report on pages 14 to 19.

Corporate governance

Statements on corporate governance and directors' roles and responsibilities are set out in the Corporate Governance Report on pages 40 to 51.

Colleagues

Information on key colleague policies and associated key performance indicators are included in the Strategic Report on pages 30 to 31.

Environmental policy

The Society's approach to the environment is summarised in the Corporate Responsibility Report on pages 32 to 35.

Charitable and political donations

In 2017 the Group made a donation of £90,000 (2016: £90,000) to the Leeds Building Society Charitable Foundation. Other Society donations to charities and good causes (including colleague fund matching) during the year amounted to £45,000 (2016: £46,000).

The Caring Saver Account and the Your Interest In Theirs scheme provided further donations of £18,000 (2016: £19,000) and £107,500 (2016: £99,000) respectively to specified charities.

Other charitable contributions from colleagues and members totalled £67,000 (2016: £91,000) taking total donations to charity and good causes to £327,500 (2016: £345,000). No political donations were made during the year (2016: £nil).

Creditor payment policy

The Society's policy is to agree terms and conditions with suppliers that outline the way in which business is to be transacted, including the terms of payment, and to pay in accordance with contractual and other legal obligations.

The creditor days stood at seven days at 31 December 2017 (2016: 15 days).

Mortgage arrears

At 31 December 2017, there were 201 (2016: 233) mortgage accounts 12 months or more in arrears. The total mortgage arrears, for these cases, was £3.5 million (2016: £3.8 million) and the total principal balance outstanding was £34.5 million (2016: £37.3 million).

Pillar 3 disclosures

The disclosures required under Pillar 3 of CRD IV are published on the Society's website at www.leedsbuildingsociety.co.uk/press/financial-results/

Directors' responsibilities in respect of the preparation of the Accounts

This statement is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report. It should be read in conjunction with the statement on the respective responsibilities of directors and auditor on page 88.

For each financial year, the directors are required by the Building Societies Act 1986 (the Act) to prepare annual accounts which give a true and fair view of the income and expenditure of the Society and the Group, and of the state of affairs of the Society and the Group, as at the end of the financial year. Additionally, they must provide details of directors' emoluments in accordance with Part VIII of the Act and regulations made under it. The Act states that references to International Financial Reporting Standards (IFRS) accounts giving a true and fair view are references to their achieving a fair presentation.

In preparing annual accounts, directors are required to:

- select appropriate accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether the annual accounts have been prepared in accordance with IFRS; and
- prepare the annual accounts on the going concern basis, unless it is inappropriate to presume that the Group will continue in business.

The directors consider that the Annual Report and Accounts are fair, balanced and understandable, when taken as a whole, and provide the information necessary for members to assess the Society's and Group's performance, business model and strategy.

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

Directors' responsibilities for accounting records and internal control

The directors are responsible for ensuring that the Society and its subsidiary undertakings:

- keep accounting records in accordance with the Building Societies Act 1986; and
- take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business.

The directors have general responsibility for safeguarding the assets of the Society and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance of the corporate and financial information included on the Society's website. Legislation in the United Kingdom, governing the preparation and dissemination of financial statements, may differ from legislation in other jurisdictions.

Going concern

The directors are required to prepare financial statements on a going concern basis, unless it is inappropriate to presume that the Society and the Group will continue in business for the next 12 months.

The directors undertake regular rigorous assessments of whether the Society and the Group are a going concern, considering current economic and market conditions and the potential impact of the principal risks set out on pages 14 to 19 of the Strategic Report. The directors have also reviewed the Society's and Group's position over a longer period than the 12 months required by the going concern assessment, and this is explained in the Viability Statement on pages 20 to 21 of the Strategic Report.

The directors conclude that:

- The Group maintains an appropriate level of liquidity, sufficient to meet both the normal demands of the business and the requirements which might arise in modelled stressed circumstances. The availability and quality of liquid assets are structured so that funds are available to repay any maturing wholesale funds and cover exceptional demand from retail investors;
- The Group's other assets consist primarily of mortgages secured on residential property. The recoverability of all mortgage assets is reviewed regularly and provisions are made, where appropriate, such that the Group is not exposed to losses on these assets which would impact its decision to adopt the going concern basis; and
- The Group's current capital resources are sufficient to meet regulatory requirements. Having reviewed future plans and forecasts, the directors consider plans for future capital generation, including expected profit generation, are sufficient to maintain capital in excess of regulatory requirements, under both central and modelled stressed scenarios.

The directors therefore consider that the Society and the Group have adequate resources to continue in operational existence for the foreseeable future and that it is appropriate to continue to adopt the going concern basis in preparing the financial statements.

Directors

The names of the directors of the Society at 31 December 2017, their roles and membership of Board committees are detailed on pages 37 to 39. Susan Cooklin was a director until her retirement from the Board on 6 April 2017. Lynn McManus was appointed to the Board in September 2017 and will stand for election by the members at the AGM. In line with best practice, all the remaining executive and non executive directors offer themselves for re-election by the members at the AGM. None of the directors holds any beneficial interest in shares in, or debentures of, any subsidiary undertaking of the Society.

Auditor

In accordance with Section 77 of the Building Societies Act 1986, a resolution for Deloitte LLP's reappointment as auditor will be proposed at the AGM.

Post balance sheet events

The directors consider that no events have occurred since the year end to the date of this Annual Report that are likely to have a material effect on the financial position of the Group as disclosed in the Annual Accounts.

Katherine Tong
Director of Legal and Compliance and Secretary

27 February 2018

Board Risk Committee Report

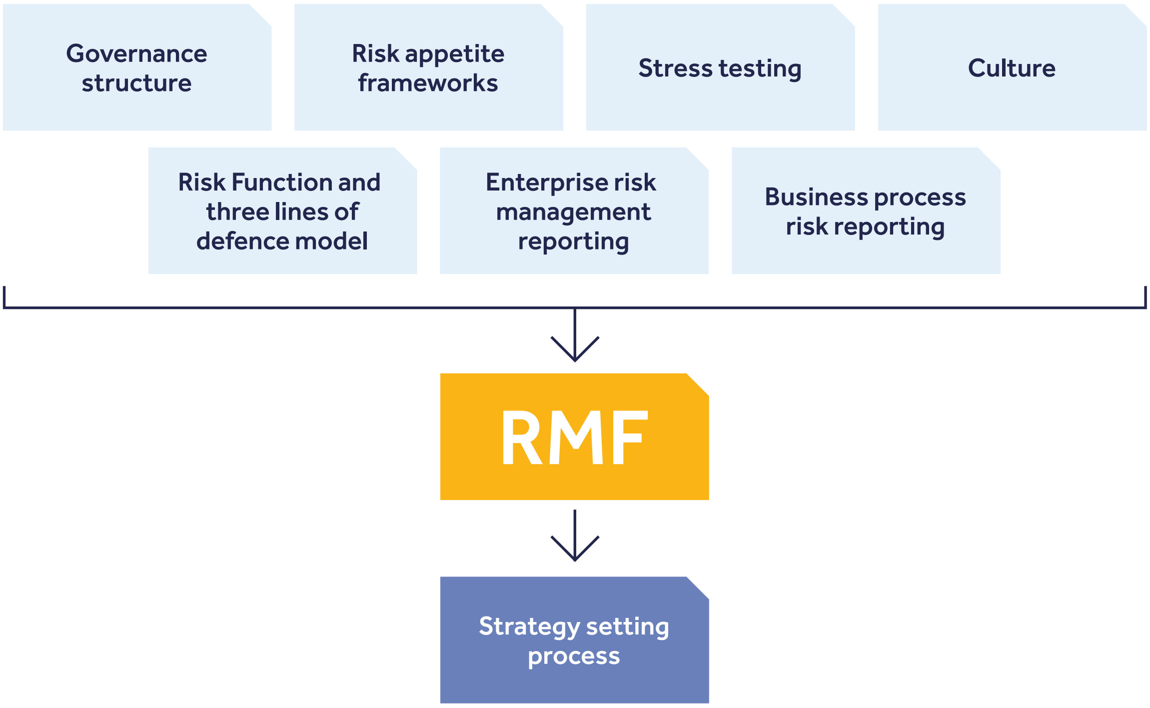
Year ended
31 December 2017

Dear member,

As Chair of the Board Risk Committee (BRC), I am pleased to present the 2017 Board Risk Committee Report. This report presents the Society's approach to risk management, including the activities of the BRC and also the Models and Rating System Committee (MRSC), during the year.

Approach to risk management

The Risk Management Framework (RMF) defines the structured approach to identifying, assessing, controlling and monitoring risks across the Society. This ensures a consistent approach to the management of all risks and is used to inform business management and decision making, at both strategic and operational levels. The RMF is reviewed annually by the BRC, on behalf of the Board. The Chief Risk Officer (CRO) has responsibility for its implementation.



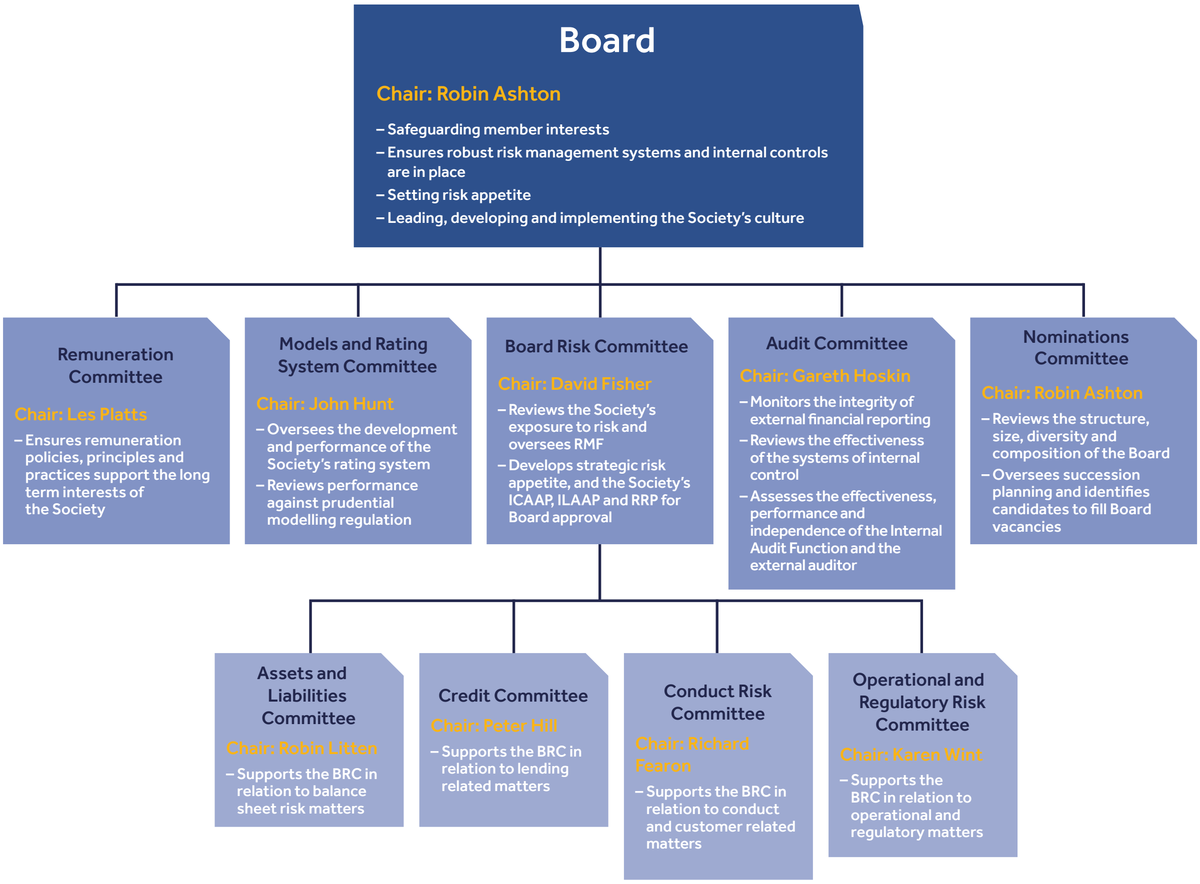
The main components of the framework are outlined below:

Risk governance

Risk governance refers to the mechanisms through which risk based authorities are cascaded from the Board to committees or individuals to manage the day to day activities of the Society. The main routes of delegation are as follows:

Delegation route	Summary
1. Committee structure	The various Board committees and executive committees are able to approve relevant business activities. Mandates are detailed under the agreed Terms of Reference.
2. Policy framework	Delegated mandates and limits are also approved through the Society's suite of policies, which are reviewed on an annual basis by the Board or relevant Board committee.
3. Delegated Authority Manual	The Delegated Authority Manual is designed to facilitate the effective discharge of responsibilities and continuity of operations within a sound system of financial, operational and budgetary control. It is reviewed by the Board annually.
4. Corporate Plan	Subsequent to the approval of the Strategic Risk Appetite, the Corporate Plan provides the annual Board approved parameters within which management can operate.

Responsibility for risk oversight is primarily delegated to BRC from the Board. The BRC is responsible for oversight of the entire risk universe, supported by four executive risk committees, each focusing on particular disciplines of risk.



Three lines of defence model and the Risk Function

The Society's approach to risk management aligns to a 'three lines of defence' model, which is standard practice within the financial services sector. This ensures a clear delineation of responsibilities between control over day to day operations, risk oversight and independent assurance of activities. The key accountabilities under the three lines of defence model are detailed below:

First Line (Business Lines)	Second Line (Risk Function)	Third Line (Internal Audit)
• executes strategy • identifies and manages own risks • defines risk appetite for approval by the Board • adheres to policies and standards • implements and maintains regulatory compliance • identifies emerging risks	• oversees day to day activities of the first line • maintains the RMF • coordinates and oversees the setting of risk appetite • acts as guardians of policies • identifies emerging risks • enterprise risk reporting • conducts independent risk based assurance	• provides independent assurance of the adequacy and effectiveness of first and second line risk management, on a risk based approach

Board Risk Committee Report

Year ended
31 December 2017

Continued

The Risk Function is independent from the operational business divisions. It ensures the Society follows a consistent approach to risk management and is led by the CRO, who reports directly to the Chief Executive Officer and is also accountable to the Chair of BRC. The Risk Function comprises specialist teams, aligned to key risk disciplines, which provide oversight and independent challenge of first line activities.

Risk culture

Risk culture is an essential element of effective risk management, underpinning how the Society's RMF is embedded across the business and into decision making. The Society operates a risk culture, built upon the following four principles:

- **Desired behaviours and tone from the top**
  Reflects the Society's values, which are clearly demonstrated by the Board and the Senior Leadership Team.
- **Accountability**
  The Society holds individuals, at all levels, accountable for risk management, to support the delivery of its strategy and business objectives.
- **Effective communication**
  The Society cultivates an environment of open and transparent communication about risk and risk taking expectations.
- **Incentives and talent management**
  The Society operates an appropriate incentive scheme and other human resource frameworks and policies to promote the desired risk culture.

Risk appetite framework

A key element of the RMF is the Strategic Risk Appetite (SRA). This comprises qualitative statements and quantitative metrics to provide the boundaries within which the Society must operate to deliver its strategy. The Society's SRA is reinforced through policies and standards, to ensure consistency and alignment to Board defined parameters.

The Board defines SRA across the Society's seven principal risk categories (defined on pages 14 to 18). The metrics are reviewed by the Board annually and are stress tested to confirm the long term viability of the Society, under both plausible and more severe scenarios. They are also forecast on a forward looking basis, within the corporate planning process.

The Board receives monthly management information on risk exposures and the Society has developed appropriate early warning indicators and escalation procedures to highlight risk profile changes.

Stress testing

Stress testing is a risk management tool used throughout the Society to support an understanding of the vulnerabilities within the Society's business model. The Society's approach to stress testing is defined within the Stress Testing Framework, which is owned by BRC and provides:

- a sound understanding of internal and external influences on the Society and its principal risks;
- enhanced risk management and complementary stress testing approaches and scenario analyses (including reverse stress testing);
- assistance to the Board in strategic business planning and setting of SRA; and
- management of capital and liquidity resources against SRA and regulatory expectations.

The Society has developed an annual programme of stress testing activity, which informs the planning process and the calibration of SRA. The key components of the programme are as follows:

Activity	Description
Corporate planning	Sensitivity analysis and a suite of alternative scenarios are used to assess the Corporate Plan under a range of severe, but plausible, stresses.
ICAAP	An internal assessment of whether the Society has sufficient capital to withstand a severe stress.
ILAAP	An internal assessment of whether the Society has sufficient liquidity and stable funding to withstand a severe stress.
Recovery planning	Scenario analysis is used to inform the development of a suite of recovery actions (primarily capital and liquidity) and operational protocols to be used under extreme stress.
Reverse stress testing	An assessment of the stress scenarios under which the Society would potentially become unviable. This examines potential weakenesses in the Society's business model under extreme events so that mitigating actions can be identified (as appropriate).

Enterprise and business process reporting

The Society's RMF details the operating model under which there is consistent identification, measurement, management, monitoring and reporting of risks across the Society. The Risk Function aggregates and co-ordinates risk reporting to assess performance against appetite at each BRC and Board meeting.

Board Risk Committee review

Constitution and frequency

The Committee consists of four independent non executive directors: David Fisher (Chair), Philip Jenks, John Hunt and Gareth Hoskin.

All members have strong backgrounds within banking and financial services and the Committee benefits from cross membership with other Board committees. Full biographies of Committee members can be found on pages 37 to 39.

During the year, the Committee held eight meetings. At the invitation of the Committee, meetings were attended by the executive directors and other members of the Senior Leadership Team, ensuring that the three lines of defence were represented. In addition, the Committee extends an open invitation to all other non executive directors.

BRC responsibilities and 2017 focus areas

Responsibilities of the BRC
• oversee the development, implementation and effectiveness of the RMF (including the Stress Testing Framework);
• oversee the formation of the Society's risk appetite;
• monitor the risk profile of the Society in relation to appetite, through appropriate management information;
• monitor the effectiveness of risk management and internal control systems;
• oversee the development and embedding of an appropriate risk culture;
• review and approve the Society's suite of appropriate level 1 policies;
• review and recommend to the Board key prudential documents (ILAAP, ICAAP, RRP);
• ensure that the Society's remuneration arrangements reflect appropriate risk considerations; and
• oversee the activities of executive risk committees.
The full BRC Terms of Reference are available from the Corporate Governance section of the Society's website.

2017 focus areas	
Topic	**Activity**
Frameworks and policies	• annual review and approval of the RMF (including the Stress Testing Framework); and • review and approval of appropriate Level 1 policies.
Risk appetite	• review of the Society's approach to setting risk appetite; and • annual review of risk appetite statements and metrics and recommended changes to the Board.
Stress testing	• annual review and recommendation of the ICAAP to the Board; • annual review and recommendation of the ILAAP and Liquidity Contingency Plan to the Board; • annual review and recommendation of the Recovery and Resolution Plan to the Board; and • review of reverse stress testing outputs.
Remuneration	• review of the risk adjustment process for Material Risk Takers; and • risk based assessment of corporate objectives.
Strategies	• annual review of risk maturity and plans; • review of Treasury strategy; and • review of Financial Crime strategy.
Control environment	• review of Risk Control Self Assessment outputs; and • review of cyber penetration testing results.
Monitoring of risk profile	• risk exposures in relation to appetite (through management information); • external risk assessment via the CRO report and strategic heat map; • review of annual Money Laundering Reporting Officer report; • oversight of cyber IT resilience; • thematic 'deep dive' reviews; • oversight of executive risk committees; and • monitoring risks associated with the strategic change programme.

Board Risk Committee Report

Year ended
31 December 2017

Continued

Effectiveness review

During October 2017, the Committee undertook an internal self-assessment of its effectiveness. The review was performed using anonymous questionnaires and was completed by members and regular attendees. Overall, the review concluded that the Committee was operating effectively, in accordance with its Terms of Reference.

Models and Rating System Committee (MRSC)

The Society operates a MRSC to provide dedicated oversight of model risk and the development of the Society's rating system (in relation to applicable residential mortgages).

The current focus of the Committee relates to credit risk models, with plans to widen its remit further in 2018. While MRSC currently reports directly to the Board, as the responsible body for the entire risk universe, BRC remains informed of its activities through receiving minutes and cross membership.

During 2017, the Committee held eight meetings. The Committee consists of members of the Society's Senior Leadership Team, modelling subject matter experts and was chaired by a non executive director, John Hunt. The main activities of the Committee are as follows:

Responsibilities of the MRSC
• oversight of modelling activity within the Society, on behalf of the Board; • annual approval of the Model Risk Policy; • seek assurance that the Society implements effective and compliant models and rating systems for the purposes of regulatory capital requirements and accounting standards; and • provide oversight of regulatory notification requirements. The full MRSC Terms of Reference are available from the Corporate Governance section of the Society's website.

2017 focus areas	
Topic	**Activity**
Internal Ratings Based approach	• development of a prudential regulation compliant rating system, in accordance with the strategic objective to manage capital on an Internal Ratings Based (IRB) approach; and • annual attestation of the IRB rating system.
International Financial Reporting Standard 9: Financial Instruments	• development of an expected credit loss suite of models in accordance with IFRS 9 requirements.
Model validation framework	• oversee the embedding of a robust model validation framework, applying statistical tests and key performance indicators to appropriate aspects of model performance.
Scope of Model Risk Policy	• assessing the application of established credit risk modelling disciplines across appropriate modelling activity at the Society.
Credit risk forecasting models	• annual review and approval of the Society's credit risk forecasting models.
Management information	• frequent review of scorecard and IRB model related management information.

Similar to BRC, MRSC undertook an internal self-assessment of its effectiveness of its performance during the year. The review concluded that the Committee was operating effectively, in accordance with its Terms of Reference.

David Fisher
Chair of Board Risk Committee
27 February 2018

The Society's approach to risk management aligns to a 'three lines of defence' model, which is standard practice within the financial services sector. This ensures a clear delineation of responsibilities between control over day to day operations, risk oversight and independent assurance of activities.

Audit Committee Report

Year ended
31 December 2017

Dear member,

I am pleased to present the report on the work of your Audit Committee.

We have continued to receive a high standard of assurance over the risk and control environment of the Society. During the year we have noted progress in the development and implementation of new risk management software, which will further support an integrated and more consistent approach to risk management across all three lines of defence.

The Society's Internal Audit Function continues to provide an effective and independent third line of defence. The Committee is also satisfied that the external auditor remains effective and independent.

The Committee has devoted a significant amount of attention to the implementation of IFRS 9, which took effect from 1 January 2018. I am pleased to report that the Society successfully adopted the standard from the effective date.

In 2018 the Committee will continue to seek progress in the Society's risk management approach through utilisation of the new system, and will monitor the embedding of processes and controls in relation to IFRS 9.

Finally I would like to express my thanks to Susan Cooklin for her hard work and dedication to the Committee prior to her retirement in April and to welcome David Fisher and Lynn McManus who have joined the Committee during the year.

Gareth Hoskin
Chair of Audit Committee

27 February 2018

Purpose and constitution

Acting with authority delegated to it by the Board, the Audit Committee's primary purpose is to:

- monitor the integrity of the externally reported financial statements of the Society, including the review and challenge, where necessary, of the actions and judgements made by management in relation to the financial statements;
- review the adequacy and effectiveness of internal controls and risk management systems;
- oversee the effectiveness and performance of the Society's Internal Audit Function;
- assess the independence, performance and objectivity of the Society's external auditor; and
- oversee the Society's whistleblowing arrangements.

The Committee is composed solely of independent non executive directors and is chaired by Gareth Hoskin. Les Platts, Senior Independent Director, was a member of the Committee throughout the year, while David Fisher and Lynn McManus joined during the year. Susan Cooklin was a member of the Committee until she retired from the Board at the 2017 AGM. Full biographies of Committee members can be found on pages 37 to 39.

During the year, the Committee held six meetings. At the invitation of the Committee, meetings were attended by the Chief Executive Officer, Chief Financial Officer, Chief Risk Officer and the Chief Internal Auditor. The audit engagement partner from the external auditor was also in attendance, as were representatives from the Finance Division and other relevant business areas.

The Committee held two private sessions with each of the external auditor and the Chief Internal Auditor, which were not attended by management.

Committee's main activities

Financial statements of the Society

As part of its work reviewing the financial statements of the Society, the Audit Committee received and discussed reports from management and the external auditor on both the interim and full year results of the Society.

In preparing these financial statements it is necessary for management to make certain assumptions, use estimates and form judgements, some of which are of material significance. The Committee, with appropriate input from the external auditor, examined and challenged those key areas affecting the financial statements and a summary of the Committee's work during the year is set out below.

Area of focus	Reporting issue	Action taken by the Audit Committee	Conclusions
Impairment provisions – residential and commercial mortgages	This is an area of inherent accounting estimate and judgement. The level of impairment provisions required in the residential mortgage book is based on statistical models, which incorporate historical default and loss experience information, and management judgement to determine expected economic conditions. As the commercial loan book has reduced in size, the use of purely statistical models has become less appropriate and, for impaired loans, assessments are made on a loan by loan basis, paying particular attention to collateral valuations.	Reviewed and challenged reports from management on the basis of the calculation of the impairment provisions and the management judgements applied. Considered the outcome of the detailed discussions and challenges to management by the Credit Committee. The Chair of the Audit Committee attended Credit Committee discussions on impairment. The Committee paid particular attention to the appropriateness of post model adjustments made by management where current best estimates of incurred losses diverge from empirical historic trends. Considered whether movements in provisions were consistent with changes in economic conditions.	Following consideration of this information, the Committee concurred with the Credit Committee's view that management's proposals for the level of impairment provisions, including post model adjustments, are reasonable.
Hedge accounting	The Society holds derivative financial instruments in order to mitigate various business risks, including interest rate and foreign exchange risks. International Financial Reporting Standards require changes in the value of these derivatives to be recognised immediately in the Income Statement. However, if they adhere to strict accounting criteria some, or all, of the changes in the fair value of these derivatives may be offset against the changes in the fair value of the underlying items being hedged by them.	Continued to oversee management's control activities in applying the rules of IAS 39. Reviewed and challenged reports from management and the external auditor on hedge accounting methodologies and the Income Statement impacts.	The Committee has satisfied itself that amounts recognised by management in the financial statements are fairly stated and that appropriate disclosures have been made.
Fair value of complex financial instruments	The Society carries certain financial instruments at fair value throughout their lives in accordance with accounting standards. This includes derivatives, as well as some more complex products such as a collateral loan to a third party secured on equity release mortgages. The Society needs to determine the fair value of these instruments, for which open market prices may not be readily available, for recognition in the financial statements.	Reviewed the derivative valuation process alongside the hedge accounting work as set out above. Sought explanation from management to rationalise the reported movements in fair values. Reviewed the methodology for the fair valuation of the collateral loan and the derivative portfolio. Considered the alternative modelling and sensitivity analysis performed by management to provide assurance with regard to the valuation of the collateral loan and associated derivatives.	The Committee concluded that the process for valuing derivatives and the outputs of that process were appropriate. The Committee noted that the fair value of the collateral loan was a matter of judgement since open market prices are not readily available. Having reviewed and challenged the output of the alternative modelling and sensitivity analysis performed by management, the Committee concluded that the fair values recorded in the financial statements for the collateral loan and associated derivatives were within a reasonable range and are therefore considered appropriate.

Audit Committee Report

Year ended
31 December 2017

Continued

Area of focus	Reporting issue	Action taken by the Audit Committee	Conclusions
Technology infrastructure costs	During the year, the Society continued its strategic investment in technology functionality. Judgement is required in ensuring that the key elements of this expenditure are accounted for as an expense for the year, or capitalised in accordance with the relevant accounting standards. In addition, where the project evolves over time, judgement is required to determine whether the amounts capitalised to date remain supportable in light of the future benefits to be realised.	Received management's paper setting out the costs incurred and their proposed treatment. Considered whether the allocations made between revenue and capital expenditure were appropriate. Challenged management's treatment of costs incurred in an element of development which ceased during the year. Considered management's assessment of the carrying value of the capitalised amounts, in light of project revisions and the benefits expected to be realised. Discussed the appropriateness of amounts capitalised with the external auditor.	The Committee agreed with the treatment of the costs incurred and the allocation between capital and revenue expenses. The Committee concluded that development costs for the element of development which ceased during the year were correctly treated as an impairment charge. The Committee also concluded that, in respect of previously capitalised amounts, the balance sheet carrying value is supported by the benefits expected to be realised.

The Committee also considered other matters relevant to the preparation of the financial statements, with a particular focus in the following areas:

Area of focus	Reporting issue	Action taken by the Audit Committee	Conclusions
Retirement benefit obligation/surplus	The Society has a defined benefit pension scheme, which was closed to new entrants in January 2000 and was closed to future service accrual on 31 December 2014. The amounts recognised in the financial statements are sensitive to a number of assumptions, including inflation, the rate of increase in salaries and pensions, the rate used to discount scheme liabilities, the expected return on scheme assets and mortality rates. During the year the single largest sensitivity has been to the rate used to discount the scheme's liabilities.	Reviewed the assumptions set by management, based on a report from KPMG, the scheme's actuary, in particular the change to the assumption for the long term trend in future improvements to mortality. Noted confirmation from management that these assumptions, together with the disclosures in the Annual Report and Accounts, were consistent with IAS 19.	The Committee noted that the assumptions adopted by management were consistent with the actuary's report and confirmed by the external auditor. It satisfied itself with the position reported within the Annual Report and Accounts and the recognition on the balance sheet of the pension scheme surplus.
Effective interest rate	Interest income is recognised in the Income Statement by reflecting a constant yield over the expected behavioural life of the mortgage loan. The rate of revenue recognition is derived from models which are maintained by management. An estimate of future behavioural lives is required to perform the constant yield calculation. These models are particularly sensitive to movements in the life of the mortgage loan including any prepayment of the loan.	Reviewed the methodology and assumptions made in the model, including behavioural lives, which were aligned to those used in the Society's pricing and planning models and balance sheet management. Considered the impact of changes made in respect of estimated behavioural lives of the residential mortgage portfolio arising from current market conditions. Sought explanation from management as to the reasons for the movement in the effective interest rate adjustment held on the balance sheet.	The Committee concluded that the methodology and assumptions used by management are reasonable.

Area of focus	Reporting issue	Action taken by the Audit Committee	Conclusions
Provisions for liabilities and charges	The Society has set aside provisions for liabilities and charges including those for the FSCS levy and for the potential cost of customer redress, such as Mortgage Payment Protection Insurance (MPPI) and potential costs in relation to a third party product provider. The level of these provisions is dependent on management assumptions and estimates.	Reviewed and challenged reports from management, which set out the basis of the provisions. Considered the quantum of the proposed provisions in the context of actual claims experience, projections for future claims, associated costs and the proportion of claims upheld by the Financial Ombudsman.	The Committee concluded that the overall level of provisions, including the assumed impact of the Plevin ruling, the deadline for MPPI claims and the potential costs arising from the third party relationship, was appropriate.
Going concern assessment and Viability Statement	The Board is required to confirm whether the going concern assumption is appropriate for the Society to use as a basis for the preparation of its Annual Report and Accounts and has delegated this assessment to the Audit Committee. The Board is also required to provide a statement on the longer term viability of the Society and has delegated this assessment to the Audit Committee.	Reviewed and challenged the detailed report prepared by management which covered the Society's business performance, profitability, capital and liquidity forecasts. Considered the review of principal and emerging risks undertaken by the Board Risk Committee to provide comfort on the Viability Statement, including reverse stress testing of those risks. Discussed whether the Society had taken reasonable steps to manage and mitigate the impact of extreme risk events such that the Viability Statement was appropriate. Considered whether the going concern assessment and the Viability Statement were consistent with other internal information, such as the Corporate Plan and the detailed stress testing undertaken as part of the annual liquidity and capital adequacy assessments.	After reviewing the report and the additional information, the Committee concluded that the adoption of the going concern assumption to prepare the 2017 Annual Report and Accounts remained appropriate. The Committee was satisfied that the Viability Statement was appropriate.
Fair, balanced and understandable	The Society is required to ensure that its external reporting is fair, balanced and understandable and the Board has delegated this assessment to the Audit Committee.	Satisfied itself that there was a robust process for review and challenge throughout the preparation of the Annual Report and Accounts and other external reporting to ensure balance and consistency. This included: • guidance issued to those involved in drafting or reviewing the Annual Report and Accounts; • a thorough internal verification process of the factual content of the reports; and • a range of reviews of drafts of the Annual Report and Accounts to ensure consistency of disclosures and an appropriate level of balance. Also considered consistency with other internal information, including a review of the Society's performance for the year.	After consideration of relevant information and discussion with the external auditor, the Committee was satisfied that, taken as a whole, the Annual Report and Accounts are fair, balanced and understandable.

Effectiveness of internal controls and risk management systems

The Board recognises the importance of systems of internal control in the achievement of its objectives and the safeguarding of member and Society assets. It is the responsibility of first line management to design, document, operate and monitor internal controls that adhere to the Board's policies and standards. The Society operates a Risk Management Framework (RMF) that encourages a culture of sound risk management and internal control, which is overseen by Board Risk Committee and delivered through established governance mechanisms and a three lines of defence assurance model. Further details on the Society's RMF can be found on page 54.

During the year the Audit Committee sought and received controls assurance from first line business certifications, second line aggregate reporting, Internal Audit reports and from the external auditor.

First line – Management

As part of the Risk Control Self-Assessment (RCSA) process, first line management undertakes a self-assessment twice a year and documents the implementation and effectiveness of key controls, including any material deficiencies when compared to key risks recorded in the risk register. Where deficiencies arise, management identifies and records remediation activities, which are tracked to completion. Ongoing risk based monitoring of the completeness and accuracy of risk registers and RCSA submissions is performed by the second and third lines.

The 2017 RCSA exercises reflected continuing maturity of the risk assurance approach, with migration of critical control testing from the third line to the first line, with second line oversight, during the year.

Second line – Risk Function

The Committee received assurance from the Risk Function over the operation of key controls which included the outcome of the RCSA. The overall conclusions of the reports received were that the risk profile and control environment was stable and the reliability and credibility of reporting continues to improve.

The Committee has also remained appraised of developments in the Society's risk capabilities and infrastructure. During October 2017, new risk management software was implemented across the business, providing a single risk and control platform to improve the accuracy and consistency of risk identification, monitoring and reporting. During 2018, Internal Audit will also start to utilise the platform, ensuring appropriate alignment and consistency of control environment reporting across all three lines of defence.

Third line – Internal Audit Function

The Committee received regular reports from the Internal Audit Function, containing key strategic themes and control weaknesses arising from delivery of the agreed internal audit plan, together with an update on the resolution of recommended actions to improve controls. This work was designed to provide an independent risk-based assessment of the internal control environment, but it also included work on particular areas of importance and interest to the Committee, including a focus on the controls in place over change management.

Internal Audit tracked and followed up recommendations made in their reviews. In areas where higher priority recommendations were raised, the Committee received regular updates until matters were fully resolved. Overall, Internal Audit noted that its findings were received positively, including agreement of relevant and timely actions as appropriate, and that the documentation and understanding of risks and controls continues to improve.

The Chief Internal Auditor's annual report to the Committee summarised the 2017 audit findings and focused on the key themes, observations and root causes arising from Internal Audit's work. In particular, the Committee noted Internal Audit's assessment that good progress had been made in the management and governance of change initiatives, the effectiveness of risk management by the first and second lines of defence and awareness of customer centricity although it recognised that further work is still required to embed each of these principles throughout the organisation.

The report also mapped audit findings against the principal risks of the Society, identified by management and recorded in the risk registers, which confirmed appropriate audit coverage. This Annual Report concluded that the Internal Audit Function had not identified any issues that they consider would materially impact the accuracy and completeness of the financial statements.

External audit

In addition to its comments on the financial reporting assumptions, estimates and judgements, the external auditor also provided the Committee with reports on its assessment of the Society's internal control environment. This assessment is made solely for the purposes of reaching an external audit view on the Annual Report and Accounts but it does involve assessing the design and effectiveness of certain financial reporting, IT and operational controls. No high priority findings were identified from the 2016 or 2017 year end audits.

Effectiveness and performance of the Society's Internal Audit Function

The Board recognises the importance of Internal Audit in providing a reliable third line of defence and delegates to the Audit Committee the role of overseeing the effectiveness and performance of the Internal Audit Function. The Chief Internal Auditor reports directly to the Audit Committee Chair. The Committee welcomed the sustained progress being made by Internal Audit. During the year it:

- received, assessed and approved the Internal Audit planning methodology and risk based audit plan;
- received and discussed regular updates on the progress of Internal Audit's work against this audit plan and the key themes arising from it;
- received, debated and approved the Internal Audit Charter and Terms of Reference which detail the scope, purpose, authority and responsibilities of the Internal Audit Function;
- agreed the metrics to be included in Internal Audit's balanced scorecard and received an update on these at each subsequent meeting;
- received two comprehensive self assessments from the Chief Internal Auditor setting out the effectiveness of the Internal Audit Function against the agreed strategic principles and the continuous improvement priorities;
- oversaw the ongoing development of skills, competencies and qualifications within the Internal Audit Function;
- satisfied itself that, overall, Internal Audit had appropriate resources to deliver the annual audit plan;
- reviewed the gap analysis and action plan proposed by Internal Audit to ensure full compliance with the September 2017 update to the Financial Services Code; and
- held two private meetings with the Chief Internal Auditor to discuss audit and planning priorities, methodologies and ongoing developments within the Internal Audit Function.

The Audit Committee is required to commission an external quality assessment of the Internal Audit Function at least every five years and has agreed that the next review will be held in 2018, three years since the last assessment.

The Audit Committee is pleased to note that the Society's Internal Audit Function is independent, effective and fully compliant with the Chartered Institute of Internal Auditors and with the Financial Services Code. The Committee concluded that the work completed by the Internal Audit Function in 2017 has provided adequate coverage across the principal risks of the Society.

Independence, performance and objectivity of the external auditor

In undertaking its oversight of the relationship with the external auditor and their effectiveness in the external audit process, during 2017 the Audit Committee:

- received, challenged and approved the scope, materiality, coverage and timing of the external audit work, as set out in its audit planning document. This included evaluating the significant risks identified by the auditor against management's self-assessment and considering the effect of industry developments, including the risks associated with technology and cyber crime, on the audit approach;
- monitored the external auditor's execution of the agreed plan and requested early reporting of work on critical controls and accounting areas;
- reviewed and approved the audit engagement letter and fees;
- reviewed the letters of representation drafted by management and recommended these to the Board for signing;
- satisfied itself as to the qualification, expertise, resources and ongoing independence of the external auditor, including the audit engagement partner, David Heaton, who was appointed in 2015, and of key members of the audit engagement team;
- reviewed the external auditor's response to the Financial Reporting Council's Audit Quality Review report on the firm for the 2016/17 cycle;
- reviewed and approved the policy on non-audit services, including the employment of former partners or staff of the external auditor, in light of the revisions to the Corporate Governance Code. The external auditor undertook a number of non-audit assignments during the year, including regular annual review work in connection with the Society's structured funding vehicles. These assignments were conducted in compliance with the approved policy and occur typically where it is either mandatory or more efficient for the external auditor to perform the work in light of the information previously reviewed during the audit engagement. In 2017, non-audit fees, including one-off items, represented 54% of the annual audit fee; and
- held two private meetings to discuss any issues and concerns arising from the auditor's work.

Based on the above work the Committee satisfied itself that the external auditor is effective and independent.

Audit Committee Report

Continued

Other matters addressed by the Committee

IFRS 9

IFRS 9 became effective from 1 January 2018 and changes how the Society accounts for its financial instruments, including the calculation of impairment losses. The Audit Committee has overall responsibility for the Society's IFRS 9 project and during the year it:

- received regular project progress updates and information on evolving industry practice from both management and the external auditor;
- undertook training on the credit risk modelling underpinning the calculation of IFRS 9 compliant impairment losses;
- reviewed the governance arrangements around the key management decisions and judgements involved;
- considered the outputs of parallel running the models built for IFRS 9 provisioning calculations alongside IAS 39 outputs;
- gained an understanding of, and then challenged management on, key areas of judgement, in particular the economic scenarios modelled and the weightings of those scenarios;
- provided final approval of the provisioning standards and accounting policy, as well as the key management judgements supporting the application of that policy; and
- reviewed management's proposed disclosures of the initial impacts of IFRS 9 for inclusion in the 2017 Annual Report and Accounts, on page 95.

Speak Up Policy

The Committee is responsible for overseeing the Society's whistleblowing policy, known internally as the Speak Up Policy. The Chair of the Audit Committee has been appointed as the Society's Whistleblowers' Champion.

The Committee reviewed the number and nature of reports submitted and the extent of training and communication to colleagues. It also reviewed the culture of the Society in the context of whistleblowing and concluded that the Society has a positive culture which creates an environment for colleagues to raise issues.

Other reporting matters

The Committee reviewed the Society's tax strategy and approved the Tax Risk Management Policy. The Committee also approved the Financial Reporting and Disclosure Policy.

The Committee reviewed the 2017 Pillar 3 disclosures and recommended the document for approval by the Board.

Audit Committee effectiveness and training

During November, the Committee undertook a self-assessment of its effectiveness. The review was performed via anonymous questionnaires to all members and regular attendees at meetings, including the external auditor. The review concluded that the Committee had operated effectively and in accordance with its Terms of Reference. It noted that the composition of the Committee was fit for purpose and included non executive directors with the appropriate skills and experience, including three qualified accountants.

The Terms of Reference were also reviewed and updated to align them to latest governance requirements and best practice, although these did not result in any fundamental changes to the Committee's activities. The revised Terms of Reference were approved at the November meeting.

All Committee members were required to undertake relevant training as part of their overall development during the year. The Committee members also receive training, as a whole, on relevant topics from both internal and external sources. In 2017, training for the Committee included updates on IFRS 9 credit modelling, financial reporting, including IFRS 15 and 16 and tax disclosure, corporate governance and integrated assurance.

We have continued to receive a high standard of assurance over the risk and control environment of the Society. During the year we have noted progress in the development and implementation of new risk management software, which will further support an integrated and more consistent approach to risk management across all three lines of defence.

Directors' Remuneration Report

Year ended
31 December 2017

Annual Statement

Dear member

I am pleased to present the 2017 Directors' Remuneration Report, produced in compliance with the FCA dual-regulated firms Remuneration Code. It details our Annual Report on Remuneration for our executive directors, non executive directors and Material Risk Takers, for the year ended 31 December 2017.

The report is presented in two sections:

- The Remuneration Policy (pages 70 to 75) which explains how we will pay executive directors. The revised Policy will apply from the date of the Annual General Meeting (AGM) in 2018, subject to consideration of the outcome of the Ordinary Resolution.
- The Annual Report on Remuneration (pages 76 to 81), which explains how we put our existing policy into practice in 2017 and how we intend to implement our new policy in 2018.

Our members will have the opportunity to vote, on an advisory basis, on the Remuneration Policy and 2017 Directors' Remuneration Report at the AGM.

Revised Remuneration Policy for 2018

The Prudential Regulation Authority considers a firm's size, internal organisation and the nature, scope and complexity of its activities when determining which Remuneration Code rules are applicable to a firm. As a result of our consistent and sustainable growth, additional regulations have to be applied to remuneration awarded from 2018 onwards. We have, therefore, reviewed our Remuneration Policy for executive directors to ensure their compensation is constructed to reward behaviours and performance appropriate to our long term strategy and to be compliant with relevant regulations.

The Remuneration Committee believes that the balance of performance measures in the existing single variable pay arrangement, which include team based and individual performance indicators, typically focused on financial, customer and colleague metrics, has worked well and should be retained. However, the opportunity has been taken to reduce the maximum bonus potential from 75% to 50%, reducing the incentive to take undue risk to achieve higher variable pay, in line with our customer ethos and mutual model. Target performance will yield a payment of 36% of base salary (formerly 51%).

To ensure the overall remuneration package remains competitive, basic pay has been increased from 1 January 2018 by around 12% for the executive directors, with the exception of the Chief Risk Officer who already has maximum variable pay of 50% of basic salary. The salary adjustment takes into account the arrangements of the new schemes, detailed below. Full details are provided on page 75. These basic pay changes do not take into account the normal annual review of pay and benefits for 2018, which are also detailed.

The key features of our proposed policy from 2018, set out in full on pages 70 to 75, are:

- Maximum variable pay of 50% of basic salary for all executive directors.
- 60% of the variable pay of the Chief Executive Officer and Chief Financial Officer will be subject to deferral and will vest pro-rata over a period of seven years, with no vesting until three years after the award is made. 50% of each element of variable pay will be delivered using a share-like instrument (explained in more detail on page 72), which will be retained for a further 12 months, post-vesting.
- 40% of the variable pay of the Chief Commercial Officer, Chief Operating Officer and Chief Risk Officer will be subject to deferral and will vest pro-rata over a period of three years.
- The variable pay for all executive directors is subject to risk assessment. Deferred awards will be subject to the application of malus, whilst paid awards for the Chief Executive Officer and Chief Financial Officer will be subject to clawback for up to seven years from the date of payment in appropriate circumstances (and up to ten years in specific conditions).

For 2018, the Committee has agreed the performance measures for the executive directors' variable remuneration, which are aligned to our short and long term strategy and objectives. The financial metric relates to our profit objective, providing security to our members. The priorities which will be remunerated under the performance element are designed to support our strategy and culture and include customer experience, colleague engagement, our mortgage lending and broker satisfaction aspirations and cost management. Each executive director is also set personal objectives relevant to their individual responsibilities. In line with our continuing commitment to the Women in Finance Charter and our people agenda, each executive director has a personal objective related to the implementation of our diversity and inclusion strategy.

2017 performance and awards
The Board supports the Society's ambitious strategy, designed to ensure we have a prosperous, sustainable business, focused on meeting our members' needs. For 2017, the Board set six corporate priorities for executive directors, related to profit, customer satisfaction, colleague engagement, sustainable growth, segmented mortgage lending and cost management.

Earlier sections of the Annual Report and Accounts have explained that we have delivered a strong financial performance. In 2017, we achieved profit before tax of £120.9 million (2016: £116.6 million), which was significantly ahead of our target of £96.4 million. No significant conduct or prudential issues have arisen relating to profit incentivisation.

During the year, a focus for the executive directors has been the sustainable growth of quality lending and ensuring we are using our expertise for the benefit of our members, by having a broad product range. We have delivered net lending of £1.8 billion (2016: £1.9 billion). The Committee is satisfied this has been achieved at an appropriate margin, within our agreed risk appetite, was balanced with the delivery of other priorities and is as a result of strong management performance.

In 2017, we wanted to continue our journey of delivering outstanding service to all our members and our customer satisfaction measure is 91%, which was above plan, but still leaves us with more we want to do. It remains a key priority for us to meet our members' changing expectations, understandably interconnected with our online capability, which continues to be challenging.

Our colleagues continue to work hard and deliver consistently, giving members a great experience. We have retained our Best Companies accreditation and our colleague engagement increased to 80% (2016: 78%).

The long term sustainability of the business is vital to the Board and the Society has further matured its risk management approach. A focus for 2017 has been a more effective use of our resources and, as a result, we have delivered more cost savings than planned, through targeted efficiencies.

The Remuneration Committee has considered the performance of the organisation and the executive directors in detail, taking into account the areas of strong performance and those elements where we had hoped to do better. A breakdown of the outturn of the corporate and personal objectives is provided on page 78.

As a result, annual bonuses of between 42.7% and 66.1% have been awarded to the executive directors, which represents between 84% and 88% of the maximum award available. 40% of the bonus awards will be deferred and paid in equal instalments over the next three years.

A full risk assessment process is undertaken, during which the Remuneration Committee considers a range of factors and input from the Board Risk Committee. This includes whether the executive directors have operated within the Society's agreed risk appetite, the exposure of the business to any significant regulatory or control failings and any financial exposure arising from inappropriate management behaviour. The risk assessment process determined that the Remuneration Committee should assess whether an adjustment was required. Following full consideration, no adjustment was applied.

In April 2017, following external benchmarking and as reported last year, the Remuneration Committee agreed salary increases of 14.7% for the Chief Risk Officer, 12.2% for the Chief Operating Officer and 4.0% for the Chief Commercial Officer. The salaries of other executive directors increased by 2.0%, as did the Chairman's fee. The basic salary increase for other colleagues ranged from 0% to 4%, with an average of 2.3%.

A small number of other colleagues, who are senior managers whose actions can have a material impact on the risk profile of the Society, are considered to be Material Risk Takers. The average salary increase for this group in 2017 was 4.8%.

Other matters considered by the Remuneration Committee
The key focus of the Remuneration Committee is to set our Remuneration Policy including pay, variable remuneration and other benefits for executive directors and Material Risk Takers. Our aim is to maintain market competitive salaries and other benefits, recognising the responsibility placed on our senior people in respect of the Society's long term future. This is to ensure we are able to attract and retain the appropriate talent to deliver our goals.

I chair the Remuneration Committee which has had two other non executive director members in 2017: David Fisher and Philippa Brown. The membership has been increased from January 2018, with Lynn McManus and Gareth Hoskin joining the Committee to provide succession planning. The Chairman, Chief Executive Officer and other senior managers may be invited to attend meetings, but are not members. Our Director of People, Becky Hewitt, is the Committee Secretary.

There were four meetings in 2017, dealing with the review of compliance with the Remuneration Code, the setting and review of performance against objectives, considering the underlying measures of success for the annual schemes, Gender Pay Gap reporting and the oversight of reward for the general colleague population. In addition to the review of variable and fixed remuneration for executive directors, the Committee reviewed the Service Agreements of the executive directors to ensure they remain compliant with current legal requirements and market conditions. As a result of this, the Committee has extended the policy on payment for loss of office to include pension benefits, as well as basic salary, for good leavers (page 74).

Summary

I trust you will find this report helpful and informative. The Remuneration Committee recommends that members vote in favour of the 2017 Directors' Remuneration Report and Remuneration Policy at the AGM.

Les Platts
Chair of the Remuneration Committee

27 February 2018

Directors' Remuneration Policy

The Society's Remuneration Policy is designed to provide value for members, provide competitive remuneration packages which support the long term interests of the Society and which attract, reward and retain talented colleagues, to enable the delivery of business objectives to support the Society's strategy.

Remuneration principles

In delivering this policy, the following principles are observed:

- The Remuneration Policy is clearly linked to the Society's business strategy, objectives, values and the long term interests and security of the Society and its members.
- The Policy, procedures and practices are consistent with, and promote, sound and effective risk management. They balance fixed and variable remuneration to create an acceptable relationship between risk and reward, while not encouraging risk taking that exceeds the level tolerated by the Society.
- Basic salary and total remuneration is set at a competitive level to attract, retain and motivate people of the required calibre.
- Pay policies meet regulatory requirements, including the FCA Dual-Regulated Firms Remuneration Code, PRA Rulebook and good corporate governance practice.

Policy review

The Remuneration Policy is subject to an annual review of both its content and implementation and is approved by the Remuneration Committee. The Board Risk Committee also contributes to the policy review, to ensure it takes sufficient account of risk considerations.

Vote

Members are asked to vote on the Remuneration Policy every three years, unless the Policy changes. The current Remuneration Policy took effect from the date of the 2017 AGM.

Annual General Meeting 2017 Results

Resolution	% votes for	% votes against
Directors' Remuneration Report	90.11%	9.89%
Directors' Remuneration Policy	89.29%	10.71%

Components of remuneration

The following table summarises the principal components of the executive directors' total remuneration and the way they operate with effect from 1 January 2018. Details which are commercially sensitive have not been provided, but performance against targets is disclosed. The table below shows the key elements of remuneration for executive directors and the reasons for their inclusion.

Element of pay	Link to strategy	Operation	Performance measures	Minimum and maximum payable
Basic salary	Reflects level of accountability. Provides ability to attract and retain executives through market competitive rates of pay.	Once set, any future increases are linked to personal performance and market benchmarking. Basic salaries are based on assessments of individual performance and by comparisons with roles carrying similar responsibilities, in organisations of a comparable size, complexity and diversity to the Society.	As for all colleagues, increases are based on personal performance.	Whilst there is no specified maximum, the basic salaries of executive directors are reviewed as for any other colleague in accordance with the standard award matrix. The only exceptions are: (i) If benchmarking identifies remuneration is moving out of line with an appropriate peer group, from time to time the Committee may decide to operate outside the standard matrix. (ii) There is a material increase in scope or responsibility to the executive director's role.
Annual bonus scheme	Linked to the delivery of the annual business plan targets, including the achievement of strategic objectives and personal objectives and links to the success factors in the ten year vision.	Challenging performance objectives are aligned with our Corporate Plan, recognising short, medium and long term goals. The performance of the executive directors is assessed against a scorecard of measures, to ensure significant reward cannot be achieved by the delivery of high performance in one area, to the detriment of another. Robust risk evaluation measures are independently assessed by the Chief Risk Officer and the Board Risk Committee, with measures for the Chief Risk Officer assessed by an independent senior manager.	The 50% maximum is split between: Financial – 17% Performance – 17% Personal – 16%. The financial measure is based on profit. Performance measures are set at the start of each year and include sustainable growth, delivering outstanding service to all our members and colleague engagement. Personal performance objectives, appropriate to the responsibilities of the director, are set at the start of each year and agreed by the Remuneration Committee. The 50% maximum for executive directors in a control function is based on a range of personal objectives only.	Maximum of 50% of basic salary payable. For executive directors designated as 'Senior Managers' under the Senior Managers Regime and over the de-minimis[1] 60% of the bonus will be deferred, over a period of seven years with no vesting until three years after the award is made. 50% of variable will be delivered in a share-like instrument[2]. For executive directors designated as 'Senior Managers' under the Senior Managers Regime and below the de-minimis 40% of the bonus will be deferred over three years. Should the de-minimis requirements be exceeded in year, the relevant additional deferral and use of the share-like instrument will be applied. Minimum is 0% of basic salary.
Operation of malus and clawback [3]	Deferred element has been introduced in compliance with applicable regulations and ensures the annual performance creates value sustained over the longer term.	Independent assessment takes place prior to the payment of each deferred award, which provides the Remuneration Committee with the rationale to make a reduction in the level of award payable (down to zero), if appropriate. The assessment takes into account the following three key matters: • has management operated within the risk appetite of the business? • has the business been exposed to any significant regulatory or control failings? • has there been any financial exposure after the award has been made due to inappropriate management behaviour?	Not applicable.	Maximum 100% of the deferred bonus awards are subject to malus. Clawback will be applied as required by regulation.

Year ended
31 December 2017 **Continued**

Element of pay	Link to strategy	Operation	Performance measures	Minimum and maximum payable
Pension	Provides market competitive remuneration.	Based on membership of the Society's defined contribution section of the pension scheme. In appropriate circumstances, for example where contributions exceed the annual or lifetime allowance, there is an option to receive a monthly cash allowance in lieu of pension contributions.	Not applicable.	A range of relevant employer contributions, for example for those aged 53 and over, up to 23% of basic salary. Cash allowance is in lieu of employer contributions, up to 23% of basic salary.
Benefits	Provides market competitive remuneration.	The principal benefits executive directors receive are: • life assurance • private medical insurance • long term health insurance • cash health plan. Other benefits may be provided based on individual circumstances, for example, relocation.	Not applicable.	Life assurance (up to 4 x basic salary). Other benefits are set at an appropriate level in line with market practice.

(1) The de-minimis limit level is set by regulation, in relation to the level of bonus deferral applied, and impacts colleagues whose total remuneration is greater than £500,000 per annum and/or where variable remuneration is more than 33% of their total remuneration.

(2) Where remuneration exceeds the de-minimis, 50% of the variable remuneration award will be paid in an instrument and 50% will be paid in cash. As a mutual organisation, this means that 50% of the award payable in each year will be held and retained for a further 12 months and which can be written down in value if agreed capital levels are not maintained. The instrument cannot increase in value or attract interest payments during the deferral and retention periods.

(3) The Remuneration Committee may apply discretion to reduce bonus awards in whole or part. The circumstances in which this might be applied include: issues with colleague behaviour or material error, where a business unit in which a colleague is engaged suffers a material downturn, a material failure of risk management, reasonable evidence of fraud or dishonesty or misstatement of audited results.

Malus – is a reduction factor which is applied to bonus payments which have not yet vested.
Clawback – is applied to seek recovery of bonus payments already paid.

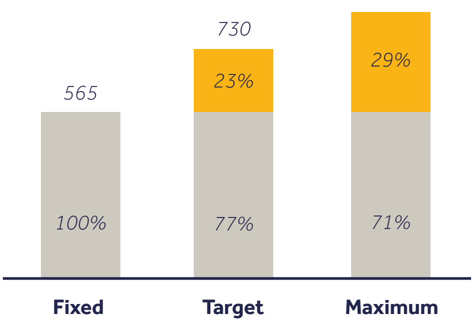
Policy for non executive directors

Element of pay	Link to strategy	Operation	Performance measures	Minimum and maximum payable
Fees	Reflects level of responsibilities and time commitment required for Board and Board subcommittee meetings.	Fees are reviewed annually with recommendations made to the Board by executive directors. Non executive directors receive a basic fee and an additional fee for chairing a committee. Fee levels are benchmarked against other financial services organisations.	Not applicable.	The fees of non executive directors are reviewed by the executive directors as for any other colleague in accordance with the standard award matrix. The only exceptions are: (i) If benchmarking identifies remuneration is moving out of line with an appropriate peer group, from time to time the Board may decide to operate outside the standard matrix. (ii) There is a material change in responsibility to the non executive director's role.
Annual Bonus Scheme	Not eligible.			
Pension	Not eligible.			
Benefits		Reimbursement is made for travel expenses for attending meetings and, where a tax liability arises, this will be covered by the Society.		

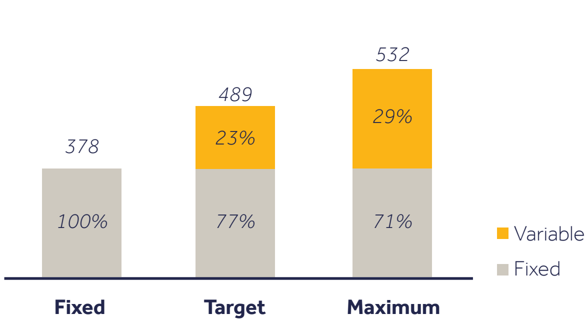
Awards under different scenarios

The charts below show the awards split between fixed pay and variable pay, under the proposed variable pay arrangements, for each current executive director under different scenarios:

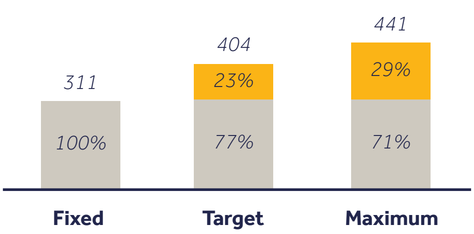
Chief Executive Officer £'000s



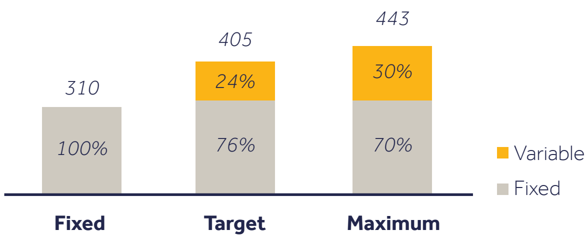
Chief Financial Officer £'000s



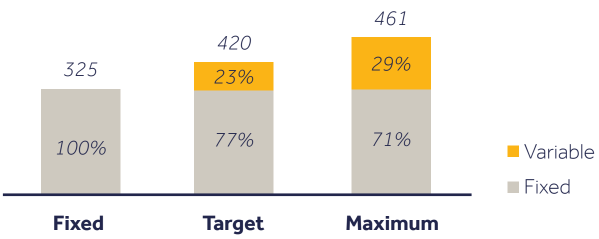
Chief Operating Officer £'000s



Chief Commercial Officer £'000s



Chief Risk Officer £'000s



In developing the scenarios, the following assumptions have been made:

Fixed

Consists of basic salary and pension (£'000)
Basic salary is as at 1 January 2018

Executive director	Basic salary	Pension	Total fixed
Chief Executive Officer	459	106	565
Chief Financial Officer	307	71	378
Chief Operating Officer	259	52	311
Chief Risk Officer	271	54	325
Chief Commercial Officer	265	45	310

Target

Based on what a director would receive if the target level of performance was achieved: annual variable element pays out at 72% of the maximum available (70% for the Chief Risk Officer).

Maximum

Based on what a director would receive if the maximum level of performance was achieved: annual variable element pays out at 100% of maximum available.

Year ended
31 December 2017 **Continued**

Approach to recruitment remuneration for executive directors

Component	Policy
General	The Committee's approach to recruitment remuneration is to pay no more than is necessary to attract appropriate candidates to the role. A new recruit may be appointed on lower than market rate salary with phased increases to bring to market level. Any new executive director's package will be consistent with our Remuneration Policy, as set out in this report. The Remuneration Policy is compliant with the provisions of the Remuneration Code. Where an executive director is appointed internally, all previous commitments relating to remuneration will be honoured, subject to meeting the relevant criteria.
Basic salary and benefits	The salary level will be set taking into account the responsibilities of the individual and by comparison with roles carrying similar responsibilities, in organisations of a comparable size, complexity and diversity to the Society. The executive director will be eligible to receive benefits as set out in the Remuneration Policy table.
Annual bonus	The executive director will be eligible to participate in the annual bonus scheme as set out in the Remuneration Policy table. The bonus award will be pro-rated to the number of complete months worked during that year.
Pension	The executive director will be able to participate in the defined contribution section of the pension scheme or to receive a cash allowance of up to a maximum of 23% of basic salary.
Replacement awards	When replacement awards cannot be avoided, the Committee will structure any such awards so that, overall, they are no more generous in terms of quantum or vesting period than the awards due to be forfeited. In determining the quantum and structure of these commitments, the Committee will seek to replicate the fair value and, as far as practicable, the timing and performance requirements of remuneration foregone.
Recruitment remuneration	Any payments made to executive directors on joining the Society to compensate them for forfeited remuneration from their previous employer will be compliant with the provisions of the PRA Rulebook and the FCA Dual-Regulated Firms Remuneration Code.

Service contracts

Executive directors' terms and conditions of employment, including details of remuneration, are detailed in their individual service agreements, which include a notice period of twelve months.

The standard contract is available to view at the Society's Head Office.

None of the executive directors currently holds any paid external directorships.

The non executive directors do not have service contracts with the Society.

Policy on payment for loss of office

Component	Policy
General	When determining any loss of office payment for a departing individual, the Committee will seek to minimise costs to the Society whilst seeking to reflect the circumstances in place at the time. Accordingly, the Committee retains overriding judgement to make loss of office payments appropriate to the circumstances and applying the overriding principle that there should be no element of reward for failure.
Basic salary and benefits	In the event of termination by the Society, there will be no compensation for loss of office due to misconduct or poor performance. In other circumstances, executive directors may be entitled to receive compensation for loss of office. Such payments will be based on the monthly salary and pension contributions that the executive would have received if still in employment with the Society. Executive directors are expected to mitigate compensation for loss of office in appropriate circumstances.
Annual bonus	Where an executive director's employment is terminated during or after the end of a performance year but before the payment is made, the executive may be eligible for a pro-rated annual bonus for that performance year, subject to an assessment based on performance achieved over the period and subject to risk adjustment. No award will be made in the event of misconduct. Where an executive director leaves the Society after an award is made, deferred payments will remain payable, subject to the normal rules of the scheme, including risk adjustment. The Remuneration Committee has the right to exercise judgement to the level of any of the above awards.

Statement of consideration of conditions elsewhere in the Society
The Remuneration Committee considers the increase in general basic salary for the wider colleague population when determining the annual salary increases for the executive directors.

In April 2017, following external benchmarking and as reported last year, the Remuneration Committee agreed salary increases of 14.7% for the Chief Risk Officer, 12.2% for the Chief Operating Officer and 4.0% for the Chief Commercial Officer. The salaries of other executive directors increased by 2.0%.

Statement of implementation of Remuneration Policy in the following year
The Remuneration Policy is implemented by management. A formal review of the implementation of the policy is conducted by the Remuneration Committee on an annual basis.

As reported earlier, the growth in total assets means that additional requirements will apply to remuneration awarded in respect of 2018 onwards. Accordingly, the variable pay opportunity for executive directors will be reduced from 75% of salary to 50% of salary, with effect from January 2018.

The executive directors' salaries during the period 1 January 2017 to 1 January 2018 are set out below. The increases show the annual pay increase awarded from 1 April 2017 and the salary adjustment to rebalance variable and fixed remuneration from 1 January 2018. The salary adjustments reflect that the Chief Executive Officer and the Chief Financial Officer move to the 'over de-minimis' scheme, with 60% deferral over a period of seven years, while the Chief Commercial Officer and the Chief Operating Officer move to the 'below de-minimis' scheme, with deferral over three years.

	1 January 2018	1 April 2017	1 January 2017
P A Hill	£ 459,000	£408,000	£ 400,000
R S P Litten	£ 307,000	£273,620	£ 268,255
K R Wint	£ 259,000	£235,238	£ 209,725
A J Greenwood	£ 270,606	£270,606	£ 236,000
R G Fearon	£ 265,000	£239,850	£ 230,625

The annual pay review takes place in April, for all colleagues in the Society, including executive directors. Following a market review and external benchmarking, salaries from this date will be as follows:

	1 April 2018	Increase
P A Hill	£470,020	2.4%
R S P Litten	£325,000	5.86%
K R Wint	£265,220	2.4%
A J Greenwood	£277,110	2.4%
R G Fearon	£271,360	2.4%

The Remuneration Committee has agreed a salary increase of 5.86% for the Chief Financial Officer, to reflect market conditions and his experience in the role. The salaries of other executive directors will increase by 2.4%, in line with the pay review for other colleagues.

Continued

Annual Report on Remuneration

Total remuneration summary

The total remuneration received by executive directors for 2017 is detailed below, compared with 2016. The total remuneration for executive directors equates to 2.1% of profit before tax (2016: 2.0%). This information has been audited and shows remuneration for the years ending 31 December 2016 and 31 December 2017, as required to be reported under the Building Societies (Accounts and Related Provisions) Regulations 1998.

The awards made in respect of performance in 2017 are in line with the 2017 Remuneration Policy, with a maximum variable pay of 75% for executive directors, with the exception of the Chief Risk Officer, at 50%. Full details of the 2017 Remuneration Policy are available in the 2016 Annual Report and Accounts.

The Chief Executive Officer is the Society's highest paid colleague and no colleague earns more than any executive director. As the Society is a mutual organisation, it has no share capital and, therefore, does not offer share based remuneration to executive directors or colleagues.

2017 audited

Executive directors	Salary	Annual bonus	Pension	Loss of office	Total remuneration
	£'000	£'000	£'000	£'000	£'000
P A Hill	406	266	93(1)	–	765
R S P Litten	272	176	63(1)	–	511
K R Wint	229	148	46(1)	–	423
A J Greenwood	262	116	53(1)	–	431
R G Fearon (2)	238	158	39 (1)	–	435
Total remuneration(3)	**1,407**	**864**	**284**	**–**	**2,565**

2016 audited

Executive directors	Salary	Annual bonus	Pension	Loss of office	Total remuneration
	£'000	£'000	£'000	£'000	£'000
P A Hill	387	252	89(1)	–	728
R S P Litten	267	168	58(1)	–	493
K R Wint	208	130	42(1)	–	380
A J Greenwood	233	94	57(1)	–	384
R G Fearon (2)	198	124	34	–	356
Total remuneration(3)	**1,293**	**768**	**280**	**–**	**2,341**

Notes
(1) These directors elected to receive part or all of the Society's pension contribution as a cash allowance.
(2) This director was appointed on 19 February 2016.
(3) No director received other taxable benefits of £1,000 or above.

Unpaid deferred elements of the annual bonus scheme

Executive directors	Performance year	Due 2018 £'000	Due 2019 £'000	Due 2020 £'000	Due 2021 £'000	Total £'000
P A Hill	2014	27	–	–	–	27
	2015	30	30	–	–	60
	2016	34	34	33	–	101
	2017	160	35	35	36	266
	Total	**251**	**99**	**68**	**36**	**454**
R S P Litten	2014	20	–	–	–	20
	2015	21	21	–	–	42
	2016	22	22	23	–	67
	2017	106	23	23	24	176
	Total	**169**	**66**	**46**	**24**	**305**
K L Rebecchi	2014	16	–	–	–	16
	2015	9	8	–	–	17
	2016	–	–	–	–	–
	2017	–	–	–	–	–
	Total	**25**	**8**	**–**	**–**	**33**
K R Wint	2014	16	–	–	–	16
	2015	17	17	–	–	34
	2016	17	17	18	–	52
	2017	89	19	20	20	148
	Total	**139**	**53**	**38**	**20**	**250**
A J Greenwood	2015	13	12	–	–	25
	2016	12	13	13	–	38
	2017	69	15	16	16	116
	Total	**94**	**40**	**29**	**16**	**179**
R G Fearon	2016	17	16	16	–	49
	2017	95	21	21	21	158
	Total	**112**	**37**	**37**	**21**	**207**
Total		**790**	**303**	**218**	**117**	**1,428**

The payment of deferred elements is subject to future performance, for example, the application of malus. Clawback will be applied as required by regulation.

Risk assessment

The risk assessment process is independently managed by the Risk Function. Following completion of the risk assessment process, the CRO provides an annual report on areas the Remuneration Committee should consider in respect of whether or not performance or risk adjustment is necessary to remuneration outcomes. The report is initially reviewed by the Board Risk Committee, which then highlights any specific areas for further consideration to the Remuneration Committee. In addition, the Risk Function considers the corporate priorities and personal objectives for executive directors' future year remuneration, to ensure they are aligned with the Society's risk appetite.

The report from the CRO includes an assessment of the current year's performance, in the context of objectives for each prior year for which variable remuneration has been deferred.

The individual performance of Material Risk Takers and their teams is risk assessed by reference to a range of key dimensions, including audit findings, compliance with regulatory policies, compliance with the Society's risk appetite, and general control and governance matters.

The Board Risk Committee considered the 2017 report in full and determined the Remuneration Committee should assess whether an adjustment was required. Following full consideration, no adjustment was applied.

Year ended
31 December 2017

Continued

Performance outcomes against targets for incentive awards

The 2017 scheme has generated awards of between 42.7% and 66.1% (2016: 39.6% and 64.7%) of salary for executive directors, reflecting between 84% and 88% (2016: 79% and 86%) of the maximum award available.

The 2017 scheme provides for:

- financial performance measures (max. 25% opportunity, with 8% of this for superior performance);
- corporate performance measures (max. 25% opportunity, with 8% of this for superior performance); and
- personal performance measures (max. 25% opportunity, with 8% of this for superior performance).

For the executive director in a control function the scheme provides for:

- personal performance measures (max. 50% opportunity, with 15% of this for superior performance).

Annual incentive

For 2017, financial performance and corporate performance incentive opportunities were based on the performance measures in the table below. The table also illustrates performance against each of the measures. Personal performance achievement for executive directors was in the range of 17.1% to 42.7%.

Vision: Strategic Pillar	**Corporate Performance Measure**	Weightings (as % of salary)	Target	Actual	Pay out %
Secure	Profit before tax	25%	£96.4 million	£120.9 million	25%
Customer focused	Sustainable growth	5%	£1.852 billion net lending with gross lending delivering 80bps simple value	£1.838 billion net lending; 98bps simple value	5%
	Expert lender	5%	£2.4 billion	£2.32 billion	4%
Service driven	Delivering outstanding service to all our members	5%	Customer satisfaction score of 90%	91%	3.4%
	Engaged workforce	5%	Retention of 1* in Best Companies accreditation	1* accreditation retained	3.4%
Efficient	Efficiency	5%	Cost : income ratio of 47.4% and 2017 management expenses not to exceed £95million.	Cost : income ratio 43.2%; management expenses £95.5 million	5%

Notes
The financial and corporate measures only apply to the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer and Chief Commercial Officer. The Chief Risk Officer is responsible for a control function and, therefore, is remunerated on personal objectives only.

Remuneration for Material Risk Takers (MRTs)

Material Risk Takers are senior managers, which include executive and non executive directors and directors whose actions have a material impact on the risk profile of the Society.

The basic salary of Material Risk Takers is determined to reflect the responsibilities of the role. Salaries are reviewed annually and increases are awarded based on personal performance, as for all colleagues. Material Risk Takers, other than non executive directors, are eligible for an annual bonus scheme. The bonus scheme for Material Risk Takers in control functions is based on the achievement of non financial objectives. In 2017, there were 28 Material Risk Takers during the year.

Aggregate remuneration for Material Risk Takers is reported in the table below.

Remuneration for Material Risk Takers

	Number of beneficiaries		Fixed pay [1]		Current year variable pay [2]		Total	
	2016	2017	2016 £'000	2017 £'000	2016 £'000	2017 £'000	2016 £'000	2017 £'000
Senior management	27	28	4,262	4,464	1,254	1,391	5,516	5,855
Other MRTs	–	–	–	–	–	–	–	–
Total	27	28	4,262	4,464	1,254	1,391	5,516	5,855

Notes

(1) Non executive directors' fees are included under fixed pay and they do not receive variable pay.

(2) £791,000 of variable pay is deferred for one or three years (2016: £677,000).

(3) Material Risk Takers who left the Society during the calendar year are included in the table above.

Pensions and other benefits

P A Hill, R S P Litten and A J Greenwood are deferred members of the defined contribution section of the pension scheme and have opted for a cash allowance in lieu of the Society's pension contribution. A J Greenwood is also a deferred member of the defined benefit section of the pension scheme. K R Wint and R G Fearon opted to receive pension benefits as part contributions to the defined contribution section of the pension scheme and part cash allowance, in lieu of the Society's pension contribution.

No executive director has the right or opportunity to receive enhanced benefits beyond those already disclosed, and the Committee has not exercised its discretion during the year to enhance benefits. Executive directors may be entitled to receive compensation for loss of office. Such payments will be based on the monthly salary and pension contributions that the executive would have received if still in employment with the Society.

Long term incentive awards made in the financial year

There were no long term incentive awards made in the financial year.

Payments to former directors

A payment of £40,078 has been made in 2017 to K L Rebecchi, the former Distribution and Marketing Director who left the business on 30 June 2015. This payment is in respect of an incentive award which was subject to deferral and risk assessment. The Committee determined that no risk adjustment was appropriate.

Directors' Remuneration Report

Year ended
31 December 2017

Continued

Remuneration for non executive directors

The fees for non executive directors are made up of a basic fee, plus a committee chair fee, as appropriate. The Chairman and Vice Chairman do not receive additional fees for roles carried out other than that of Chairman and Vice Chairman respectively.

Non executive directors	Basic fees (£'000s)		Benefits[1] (£'000s)		Committee chair fees (£'000s)		Total (£'000s)	
	2016	2017	2016	2017	2016	2017	2016	2017
R J Ashton (Chairman)	141	143	8	7	–	–	149	150
L M Platts (Vice Chairman)	62	63	4	2	–	–	66	65
P A Brown	46	47	3	4	–	–	49	51
S Cooklin [2]	46	12	3	7	–	–	49	19
D Fisher	46	47	–	–	15	16	61	63
G Hoskin	46	47	4	4	10	15	60	66
J A Hunt	46	47	4	3	10	10	60	60
P A Jenks	46	47	–	–	3	–	49	47
L R McManus [3]	–	16	–	1	–	–	–	17
Total	**479**	**469**	**26**	**28**	**38**	**41**	**543**	**538**

Notes
(1) In addition to the payment of fees, non executive directors are reimbursed for travel expenses for attending meetings and where tax liability arises, this will be covered by the Society.
(2) This director retired on 6 April 2017.
(3) This director was appointed on 1 September 2017.

An increase of 2% was agreed for the Chairman to £144,177 with effect from 1 April 2017. The fee for the Vice Chairman was increased by 2% to £63,800 and the basic non executive director's fee was increased by 2% to £47,250. The committee chair fee was increased by 2.2%.

The annual pay review takes place in April, for all colleagues in the Society, including non executive directors. Following a market review and external benchmarking, fees from this date will be as follows:

Non executive directors	Basic fees (£'000s)	Committee chair fees (£'000s)	Total fees (£'000s)
	2018	2018	2018
R J Ashton (Chairman)	148	–	148
L M Platts (Vice Chairman)	65	–	65
P A Brown	48	–	48
D Fisher	48	17	65
G Hoskin	48	17	65
J A Hunt	48	11	59
P A Jenks	48	–	48
L R McManus	48	–	48
Total	**501**	**45**	**546**

Directors' loans, transactions and related business activity

The aggregate amount outstanding at 31 December 2017 in respect of loans from the Society or a subsidiary undertaking to directors of the Society or persons associated with directors was £1,076,172 (2016: £627,636), being four mortgages (2016: four) to directors and persons connected to directors. These loans were at normal commercial rates. A register of loans and transactions with directors and their connected persons is maintained at the Head Office of the Society and may be inspected by members. There were no significant contracts between the Society or its subsidiaries and any director of the Society during the year.

Loss of office payments

There were no loss of office payments in the reporting year.

History of remuneration of Chief Executive Officer

The table below shows the total remuneration of the Chief Executive Officer over the last five years, together with the performance pay awarded as a percentage of the maximum possible.

	Total remuneration £'000	Performance pay as % of maximum
2017	765	87.0
2016	728	84.0
2015	649	86.0
2014[1]	586	79.3
2013	610	82.9

(1) Total remuneration for 2014 includes an adjustment in respect of prior year allowances.

Percentage change in salary for Chief Executive Officer

The basic salary of the Chief Executive Officer increased by 2% during 2017. This compares to an average increase of 2.3% in fixed pay awarded to all colleagues.

Relative importance of spend on pay

The following table sets out the percentage change in profit, and overall spend on remuneration in the year ending 31 December 2017, compared to the previous year.

	2017	2016	Percentage change
Profit after tax	£88.0m	£86.0m	2.3%
Colleague remuneration costs	£47.4m	£44.9m	5.6%
Headcount	1,403	1,420	(1.2%)

External advisers to the Remuneration Committee

The Remuneration Committee seeks the advice of independent, external consultants, as required. The external advisers to the Remuneration Committee in 2017 were PricewaterhouseCoopers LLP, who in 2017 provided professional advice, guidance and training to the Committee. The appointment of advisers is carried out on a basis of careful evaluation of potential providers against agreed criteria. PricewaterhouseCoopers LLP does not have any conflict of interest in advising the Remuneration Committee.

Independent Auditor's Report to the Members of Leeds Building Society

Year ended
31 December 2017

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

- **give a true and fair view of the state of the Group's and the Society's affairs as at 31 December 2017 and of the Group's and the Society's income and expenditure for the year then ended;**
- **have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union; and**
- **have been prepared in accordance with the requirements of the Building Societies Act 1986 and, as regards the Group financial statements, Article 4 of the IAS Regulation.**

We have audited the financial statements of Leeds Building Society (the 'Society') and its subsidiaries (the 'Group') which comprise:

- the Group and Society Income Statements;
- the Group and Society Statements of Comprehensive Income;
- the Group and Society Statements of Financial Position;
- the Group and Society Statements of Changes in Members' Interest;
- the Group and Society Statements of Cash Flows; and
- the related notes 1 to 36.

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union.

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 Group and the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Society.

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

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Residential loan loss provisioning • Hedge accounting • Fair value of complex financial instruments Within this report, any new key audit matters are identified with and any key audit matters which are the same as the prior year identified with
Materiality	The materiality that we used in the Group financial statements was £6.1m which was determined on the basis of profit before tax.
Scoping	All trading subsidiaries were subject to full scope audit procedures performed to an appropriate materiality. All audit work was performed by the Group audit team.
Significant changes in our approach	Capitalisation of IT costs is no longer considered a key audit matter given the write-off of certain costs (see note 14) resulting in a reduced level of accounting judgement. In addition, in the prior year we reported on revenue recognition, however this was no longer considered a key audit matter in the current year. An area of focus is ensuring the valuation of complex financial instruments held at fair value is appropriate and therefore this has been included as a new key audit matter.

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement in note 1 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Society's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

Principal risks and viability statement

Based solely on reading the directors' statements and considering whether they were consistent with the knowledge we obtained in the course of the audit, including the knowledge obtained in the evaluation of the directors' assessment of the Group's and the Society's ability to continue as a going concern, we are required to state whether we have anything material to add or draw attention to in relation to:

- the disclosures on pages 14 to 19 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 20 that they have carried out a robust assessment of the principal risks facing the Group and Society, including those that would threaten its business model, future performance, solvency or liquidity; or
- the directors' explanation on page 20 as to how they have assessed the prospects of the Group and Society, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group and Society will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We confirm that we have nothing material to report, add or draw attention to in respect of these matters.

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 forming our opinion thereon, and we do not provide a separate opinion on these matters.

Independent Auditor's Report

Year ended
31 December 2017

Continued

Residential loan loss provisioning

Key audit matter description	The Group holds £43.5 million of loan loss provisions at year end (2016: £54.2 million) against total loans and advances to customers of £15,254 million (2016: £13,462 million). The residential provision consists of a specific arrears and possessions provision, and a collective provision for loans in the good book where a loss event may have occurred in the current period but the loss has not been reported, across the UK, Spanish and Irish portfolios. Our key audit matter was pinpointed to the risk of a lack of granularity within the forced sale discount and arrears propensities assumptions associated with the UK specific arrears provision, as management, after consideration, use single nationwide assumptions. There is a risk of material misstatement that the assumptions could vary across geographical regions which may not be identified by management applying a nationwide figure across the portfolio. Furthermore, as a management overlay is applied by using historical arrears propensities rather than those recalculated from recent data, there is a risk that the overlay may not be appropriate. Given the material impact of management judgements on the measurement of the provision, we are required to consider whether there is an inherent risk of fraud through possible manipulation of this balance. Loan loss provision balances are detailed within note 8. Management's associated accounting policies are detailed on page 97 with detail about critical accounting estimates on page 99. The Audit Committee's consideration of this risk is included on page 61.
How the scope of our audit responded to the key audit matter	We evaluated the design, and tested the implementation and operating effectiveness of internal controls over the provisioning process. This included reviewing minutes from key management review forums, and evaluating the level of challenge and determining if appropriate action was taken. We challenged the appropriateness of management's simplified assumptions in relation to residential loan loss provisions by recalculating region specific forced sale discounts, and our data analytics specialists recalculated region specific arrears propensity rates from historical experience. Using a proprietary model we also independently created a collective loan loss provision using source data extracted from the Society's mortgage administration system, to compare against management's calculation. We assessed the completeness and accuracy of post model adjustments made by management which reflect the best estimate of losses incurred but which may not have been fully observed within the current arrears data. We tested the mechanical accuracy of the significant loan provisioning models, including engaging our IT specialists to test the underlying key controls, and to test data flows into the models to assess whether the data was complete and accurate.
Key observations	We consider management's specific arrears loan loss provision against the residential book to be within a reasonable range. Our independent recalculation confirmed that considering the forced sale discount and arrears propensities on a regional basis does not materially impact management's residential loan loss provision. The rationale for the post model adjustments proposed by management is appropriate and their recognition is within an acceptable range. Based on our work performed we have not noted any instances of management override of controls or indications of fraud within financial reporting of loan loss provisions.

Hedge accounting

Key audit matter description	The Society applies fair value macro hedge accounting in order to minimise the volatility of fair value measurement in the income statement. As the macro hedge evolves, hedged items and the associated derivative, incept and de-designate from the hedge relationship. There is a key audit matter that items de-designated from hedging relationships may not be correctly amortised. The net fair value adjustment to the hedged item in the macro hedge at the year-end was an asset of £35.1m (2016: £58.2m). The Society also applies fair value hedge accounting for a small number of other hedge relationships, referred to as the micro or one-to-one hedged relationships, typically in connection with managing interest rate risk associated with treasury funding transactions. Our key audit matter is to ensure that for these specific hedging relationships, for example that relating to the Covered Bond programme, any changes within the relationship have been properly accounted for. Management's chosen accounting policies are detailed on page 96. The Audit Committee's consideration of this risk is included on page 61.
How the scope of our audit responded to the key audit matter	We evaluated the design, and tested the implementation and operating effectiveness of internal controls over the hedge accounting process. We reviewed management's methodology for assessing items that have de-designated from the hedge relationship. We then substantively tested a sample of de-designated instruments by creating an expected amortisation profile and comparing that to management's calculation. We obtained evidence of management's prospective and retrospective effectiveness testing, which is required under IAS 39 to determine that hedge relationships continue to meet certain criteria, and re-performed a sample of these in relation to the Society's micro hedges. Our internal financial instruments specialists tested the valuation of hedging instruments and hedged items on a sample basis through independent recalculation. They challenged the appropriateness of key inputs into the valuations such as interest rates, volatility, exchange rates, counterparty credit ratings and valuation adjustments by reference to external and internal data. For each of the micro hedge relationships we have assessed the notional that has been designated on a monthly basis throughout the period. We also performed procedures upon source data extracted from the Society's core treasury system to identify whether the population of derivative data was accurate and complete, as well as reviewing confirmations received from counterparties and banks.
Key observations	Our testing of the designation and de-designation of items into macro hedge relationships confirmed that the overall treatment adopted, and subsequent amortisation of de-designated items, was materially correct and that hedge accounting had been appropriately applied in compliance with IAS 39 throughout the year. We have identified some areas for process improvement which have been communicated to management. Our testing confirmed that micro hedge relationships have been designated appropriately, are consistent with the Society's hedge documentation, and in line with the requirements of IAS 39.

Independent Auditor's Report

Year ended
31 December 2017

Continued

Fair value of complex financial instruments

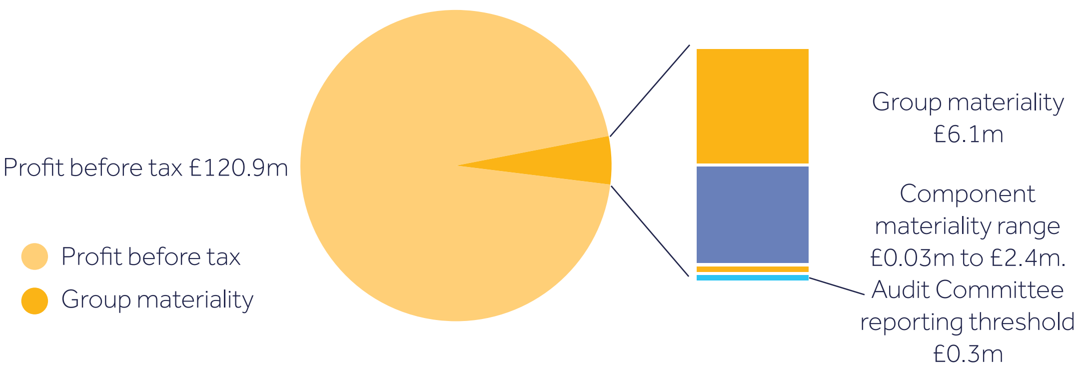
Key audit matter description	There are a number of complex financial instruments held at fair value by the Society which are classified as level 3 within the fair value hierarchy (see page 139 for a definition of level 3 measurements), and amount to a carrying value of £187.4m. These have unobservable inputs within the valuation calculation and are namely the equity release mortgages, the Retail Prices Index (RPI) linked derivative hedging the equity release portfolio and the derivatives hedging the Residential Mortgage-Backed Securities (RMBS) securitisation vehicles. The following are the unobservable inputs: • The illiquidity premium and life expectancy assumptions associated with the equity release mortgage book; • The RPI assumptions applied to the RPI linked derivative; and • The prepayment rate of mortgages within the RMBS securitisation vehicles. The Society relies on counterparty valuations to determine the fair value of these instruments but there is a key audit matter that these could be materially misstated. In addition, the Society uses a valuation methodology for the equity release mortgage book that in part relies on the valuation of complex hedging derivatives. Management's chosen accounting policies are detailed on page 96 with details about judgements in applying these policies and critical accounting estimates on page 100. The Audit Committee's consideration of this risk is included on page 61.
How the scope of our audit responded to the key audit matter	We evaluated the design and implementation of internal controls over the fair valuation of complex financial instruments. We have selected a sample of complex derivatives for testing and our pricing specialists have performed independent valuation recalculations using independently developed models. We have challenged management's valuation methodology for the equity release mortgage portfolio via reviewing the analysis provided in management's judgement paper, and independently calculating a range of appropriate valuations, utilising both internal and external data such as the discount rates, repayment profiles and credit risks associated with these assets.
Key observations	The independently recalculated complex derivative contract valuations were found to be materially consistent with the Society's valuations. Our independent assessment of management's valuation methodology for the equity release mortgage book concluded that the valuation was within a reasonable range.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

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

	Group financial statements	Society financial statements
Materiality	£6.1m (2016: £5.8m)	£6.0m (2016: £5.8m)
Basis for determining materiality	5% of profit before tax	5% of profit before tax
Rationale for the benchmark applied	This is an appropriate benchmark to use because the accumulation of profits is critical to maintaining and building capital for regulatory purposes and allowing the Group to invest in activities for its members.	This is an appropriate benchmark to use because the accumulation of profits is critical to maintaining and building capital for regulatory purposes and allowing the Society to invest in activities for its members.



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £304,000 (2016: £115,000) for the Group and £301,000 (2016: £115,000) for the Society, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including Group-wide controls, and assessing the risks of material misstatement at the Group level. Based on that assessment, we performed a full audit of the Society and all of its trading subsidiaries, executed at levels of materiality applicable to each individual entity which were lower than Group materiality and in the range of £0.03m to £2.4m (2016: £0.03m to £5.7m).

- We, as the Group auditor, were responsible for performing the audit of each subsidiary. At the Group level we also tested the consolidation process.

Independent Auditor's Report

Continued

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report *including the Strategic Report, the Corporate Responsibility Report, the Corporate Governance Report, the Directors' Report, the Board Risk Committee Report, the Audit Committee Report, the Directors' Remuneration Report*, other than the financial statements and our auditor's report thereon.

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

In this context, matters that we are specifically required to report to you as uncorrected material misstatements of the other information include where we conclude that:

- *Fair, balanced and understandable* – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's and Society's performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or
- *Audit committee reporting* – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of these matters.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, 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 Group's and the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

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

Use of our report

This report is made solely to the Society's members, as a body, in accordance with section 78 of the Building Societies Act 1986. Our audit work has been undertaken so that we might state to the Society's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Society and the Society's members as a body, for our audit work, for this report, or for the opinions we have formed.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Building Societies Act 1986

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

- the annual business statement and the directors' report have been prepared in accordance with the requirements of the Building Societies Act 1986;
- the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the information given in the annual business statement (other than the information upon which we are not required to report) gives a true representation of the matters in respect of which it is given.

In the light of the knowledge and understanding of the Group and the Society and their environment obtained in the course of the audit, we have not identified any material misstatements in the directors' report.

Opinion on other matter prescribed by the Capital Requirements (Country-by-Country Reporting) Regulations 2013

In our opinion the information given on page 145 for the financial year ended 31 December 2017 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

Opinion on other matters prescribed by our engagement letter

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the provisions of the Companies Act 2006 that would apply were the Society a quoted company.

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Building Societies Act 1986 we are required to report to you if, in our opinion:

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

We have nothing to report in respect of these matters.

Other matters

Auditor tenure

Following the recommendation of the Audit Committee, we were appointed by the Society on 15 June 2005 to audit the financial statements of the Group and Society for the period ending 31 December 2005 and subsequent financial periods. Following a competitive tender process, we were reappointed as auditor of the Group and Society for the period ending 31 December 2016 and subsequent financial periods.

Our total uninterrupted period of engagement is 13 years, covering periods from our initial appointment through to the period ending 31 December 2017.

Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs (UK).

David Heaton
(Senior statutory auditor)
For and on behalf of Deloitte
Statutory Auditor

Manchester, UK
27 February 2018

Income Statements

For the year ended
31 December 2017

	Notes	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Interest receivable and similar income	3	**413.2**	406.3	**402.7**	387.2
Interest payable and similar charges	4	**(200.0)**	(204.5)	**(188.7)**	(188.4)
Net interest receivable		**213.2**	201.8	**214.0**	198.8
Fees and commissions receivable		**8.7**	10.4	**6.9**	10.4
Fees and commissions payable		**(0.5)**	(0.8)	**(0.3)**	(0.1)
Fair value gains less losses from financial instruments	5	**(1.3)**	(1.3)	**11.9**	1.3
Other operating income		**0.9**	1.9	**0.6**	1.0
Total income		**221.0**	212.0	**233.1**	211.4
Administrative expenses	6	**(92.5)**	(88.7)	**(92.5)**	(88.5)
Depreciation and amortisation	14,15	**(3.0)**	(3.2)	**(3.0)**	(3.1)
Impairment gains on loans and advances to customers	8	**5.5**	0.9	**5.5**	0.9
Impairment losses on investments in subsidiary undertakings	13	**–**	–	**–**	(0.2)
Impairment losses on intangible assets	14	**(5.6)**	–	**(5.6)**	–
Impairment losses on property, plant and equipment	15	**(0.9)**	(0.5)	**(0.9)**	(0.5)
Provisions charge	22	**(3.6)**	(3.9)	**(3.6)**	(3.9)
Operating profit and profit before tax		**120.9**	116.6	**133.0**	116.1
Tax expense	9	**(32.9)**	(30.6)	**(32.7)**	(31.2)
Profit for the financial year		**88.0**	86.0	**100.3**	84.9

All amounts relate to continuing operations.

The notes on pages 95 to 141 form part of these accounts.

Statements of Comprehensive Income

For the year ended
31 December 2017

	Notes	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Profit for the financial year		**88.0**	86.0	**100.3**	84.9
Items that may subsequently be reclassified to profit and loss:					
Available for sale investment securities (loss) / gain		**(3.9)**	7.8	**(3.9)**	7.8
Tax relating to items that may subsequently be reclassified	28	**1.0**	(1.8)	**1.0**	(1.8)
Items that may not subsequently be reclassified to profit and loss:					
Actuarial gain / (loss) on retirement benefit surplus / obligation	26	**2.0**	(9.5)	**2.0**	(9.5)
Revaluation loss on properties revalued	15	**–**	(1.8)	**–**	(1.8)
Tax relating to items that may not be reclassified	28	**(2.4)**	3.0	**(2.3)**	1.5
Total comprehensive income for the year		**84.7**	83.7	**97.1**	81.1

Statements of Financial Position

As at 31 December 2017

	Notes	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Assets					
Liquid assets					
Cash in hand and balances with the Bank of England	10	**1,757.6**	938.9	**1,757.6**	938.9
Loans and advances to credit institutions		**194.0**	187.3	**80.9**	66.3
Investment securities	12				
– Available for sale		**763.0**	753.7	**1,290.5**	1,422.6
– Loans and receivables		**15.7**	24.1	**15.7**	24.1
Derivative financial instruments	34	**258.5**	263.1	**167.5**	174.3
Loans and advances to customers	11				
Loans fully secured on residential property		**14,908.4**	13,056.1	**14,908.4**	13,056.1
Other loans		**302.1**	351.5	**302.1**	351.5
Fair value adjustment for hedged risk on loans and advances to customers		**12.5**	70.1	**12.5**	70.1
Investments in subsidiary undertakings	13	**–**	–	**59.7**	14.5
Intangible assets	14	**5.2**	3.0	**5.2**	3.0
Property, plant and equipment	15	**54.4**	30.1	**30.6**	30.1
Retirement benefit surplus	26	**1.0**	–	**1.0**	–
Deferred income tax asset	16	**1.9**	2.6	**1.0**	1.8
Other assets, prepayments and accrued income	17	**209.7**	249.2	**304.5**	331.9
Total assets		**18,484.0**	15,929.7	**18,937.2**	16,485.2
Liabilities					
Shares	18	**13,071.5**	11,202.1	**13,071.5**	11,202.1
Fair value adjustment for hedged risk on shares		**(5.8)**	31.1	**(5.8)**	31.1
Derivative financial instruments	34	**161.9**	214.4	**153.7**	213.1
Amounts owed to credit institutions		**951.0**	572.1	**951.0**	572.1
Amounts owed to other customers	19	**254.9**	357.5	**871.1**	1,232.8
Debt securities in issue	20	**2,855.7**	2,471.2	**2,702.8**	2,158.0
Current income tax liabilities		**15.6**	14.1	**15.6**	14.0
Deferred income tax liabilities	16	**3.2**	2.7	**2.1**	2.0
Other liabilities and accruals	21	**185.6**	157.3	**175.3**	155.7
Provisions for liabilities and charges	22	**6.4**	5.3	**6.4**	5.3
Retirement benefit obligation	26	**–**	2.6	**–**	2.6
Subscribed capital	23	**25.0**	25.0	**25.0**	25.0
Total liabilities		**17,525.0**	15,055.4	**17,968.7**	15,613.8
Total equity attributable to members		**959.0**	874.3	**968.5**	871.4
Total liabilities and equity		**18,484.0**	15,929.7	**18,937.2**	16,485.2

The accounts on pages 90 to 141 were approved by the Board of Directors on 27 February 2018.
Signed on behalf of the Board of Directors by:

Robin Ashton
Chairman

Peter Hill
Chief Executive Officer

Robin Litten
Chief Financial Officer

Statements of Changes in Members' Interest

For the year ended
31 December 2017

Group 2017	**General Reserve £M**	**Available for Sale Reserve £M**	**Revaluation Reserve £M**	**Other Reserve £M**	**Total Equity attributable to members £M**
At 1 January 2017	**844.1**	**4.8**	**11.1**	**14.3**	**874.3**
Comprehensive income for the year	**87.6**	**(2.9)**	**–**	**–**	**84.7**
Reclassification of reserves	**(0.4)**	**0.4**	**–**	**–**	**–**
At 31 December 2017	**931.3**	**2.3**	**11.1**	**14.3**	**959.0**

Group 2016	General Reserve £M	Available for Sale Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Equity attributable to members £M
At 1 January 2016	765.1	(1.2)	12.4	14.3	790.6
Comprehensive income for the year	79.0	6.0	(1.3)	–	83.7
At 31 December 2016	844.1	4.8	11.1	14.3	874.3

Society 2017	**General Reserve £M**	**Available for Sale Reserve £M**	**Revaluation Reserve £M**	**Other Reserve £M**	**Total Equity attributable to members £M**
At 1 January 2017	**841.4**	**4.8**	**11.1**	**14.1**	**871.4**
Comprehensive income for the year	**100.0**	**(2.9)**	**–**	**–**	**97.1**
Reclassification of reserves	**(0.4)**	**0.4**	**–**	**–**	**–**
At 31 December 2017	**941.0**	**2.3**	**11.1**	**14.1**	**968.5**

Society 2016	General Reserve £M	Available for Sale Reserve £M	Revaluation Reserve £M	Other Reserve £M	Total Equity attributable to members £M
At 1 January 2016	765.0	(1.2)	12.4	14.1	790.3
Comprehensive income for the year	76.4	6.0	(1.3)	–	81.1
At 31 December 2016	841.4	4.8	11.1	14.1	871.4

The reclassification of reserves in 2017 relates to reallocation of deferred tax adjustments.

Statements of Cash Flows

For the year ended
31 December 2017

	Notes	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Profit before tax		**120.9**	116.6	**133.0**	116.1
Adjusted for changes in:					
Impairment provision		**(10.7)**	(10.0)	**(10.7)**	(10.0)
Provisions for liabilities and charges		**1.1**	(1.1)	**1.1**	(1.1)
Depreciation and amortisation		**3.0**	3.2	**3.0**	3.1
Impairment losses on intangibles		**5.6**	–	**5.6**	–
Impairment losses on property, plant and equipment		**0.9**	0.5	**0.9**	0.5
Non-cash and other items		**48.9**	150.4	**63.3**	144.9
Cash generated from operations		**169.7**	259.6	**196.2**	253.5
Changes in operating assets and liabilities:					
Loans and advances to customers		**(1,792.2)**	(1,880.2)	**(1,792.2)**	(1,880.2)
Derivative financial instruments		**(48.0)**	(79.5)	**(52.7)**	(21.3)
Other operating assets		**39.5**	(109.2)	**27.5**	(132.6)
Shares		**1,869.4**	1,279.8	**1,869.4**	1,279.8
Amounts owed to credit institutions and other customers		**276.3**	455.4	**17.2**	45.6
Other operating liabilities		**24.4**	85.3	**16.2**	86.2
Taxation paid		**(30.8)**	(27.1)	**(30.8)**	(26.9)
Net cash flows from operating activities		**508.3**	(15.9)	**250.8**	(395.9)
Cash flows from investing activities					
Returns from investments and servicing of finance		**2.0**	(1.8)	**2.0**	(0.8)
Purchase of investment securities		**(627.7)**	(695.7)	**(627.7)**	(695.7)
Proceeds from sale and redemption of investment securities		**622.3**	774.0	**763.6**	939.2
Purchase of property, plant and equipment		**(27.6)**	(2.8)	**(3.8)**	(2.8)
Acquisition of subsidiary undertaking		**–**	–	**(23.8)**	–
Purchase of intangible assets		**(8.4)**	(0.2)	**(8.4)**	(0.2)
Change in loans to subsidiary undertakings		**–**	–	**(21.4)**	25.9
Net cash flows from investing activities		**(39.4)**	73.5	**80.5**	265.6
Cash flows from financing activities	20				
Net proceeds from issue of debt securities		**574.5**	450.1	**574.5**	450.1
Repayments of debt securities in issue		**(218.0)**	(208.9)	**(72.5)**	(59.0)
Net cash flows from financing activities		**356.5**	241.2	**502.0**	391.1
Net increase in cash and cash equivalents		**825.4**	298.8	**833.3**	260.8
Cash and cash equivalents at the beginning of the year		**1,126.2**	827.4	**1,005.2**	744.4
Cash and cash equivalents at the end of the year	24	**1,951.6**	1,126.2	**1,838.5**	1,005.2

The presentation of 2016 cash flows for the Group and Society has been amended. The figures for issue and repayment of debt securities in issue, previously presented as £414.4m for Group and £558.8m for Society, have been split into net proceeds from issue of debt securities, repayments of debt securities in issue and non-cash items, which are now included in the reconciliation from profit before tax to cash generated from operations. Changes in loans and advances to customers, previously £(1,923.5m) for Group and Society have been amended to remove non-cash movements in the fair value adjustment for hedged risk. Similarly, changes in shares, previously £1,300.3m for Group and £1,300.4m for Society have been amended to remove non-cash movements in the fair value adjustment for hedged risk.

Notes to the Accounts

Year ended
31 December 2017

1. Accounting policies

(a) Basis of preparation
These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted for use in the European Union and in accordance with those parts of the Building Societies Act 1986 and the Building Societies (Accounts and Related Provisions) Regulations 1998 (as amended) applicable to societies reporting under IFRS.

The accounts have been prepared on the going concern basis as outlined in the Directors' Report.

These financial statements are presented in sterling and, except where otherwise indicated, have been rounded to the nearest one hundred thousand pounds. The particular accounting policies adopted are described below, and the policies, presentation and methods of computation are consistent with those applied by the Society in the prior year, except where otherwise indicated.

The following IFRS pronouncements, relevant to the Group, were adopted with effect from 1 January 2017:

- Disclosure Initiative (Amendments to IAS 7);
- Recognition of Deferred Tax Assets for Unrealised Losses (Amendments to IAS 12); and
- Annual Improvements to IFRSs 2014 – 2016 Cycle.

The adoption of the above standards has not had a material impact on the financial statements of the Group.

At the date of authorisation of these financial statements, the following standards and interpretations (which have not been applied in these financial statements) were in issue, but not yet effective:

- IFRS 9 – Financial Instruments;
- IFRS 15 – Revenue from Contracts with Customers;
- IFRS 16 – Leases; and
- IFRS 17 – Insurance Contracts.

IFRS 9 and IFRS 15 will be adopted with effect from 1 January 2018. IFRS 15 is not expected to have a material impact on the Group. The potential impacts of IFRS 16 and IFRS 17, which are effective from 1 January 2019 and 1 January 2021 respectivley, have not yet been fully assessed.

IFRS 9
IFRS 9 changes the classification and measurement of financial instruments, changes the current incurred loss basis for calculating impairment provisions to an expected loss model and introduces new rules for hedge accounting.

The only material impact on the Group's and Society's financial statements is the change to impairment provisions. Changes to classification and measurement increase the book value of a small number of investment securities by an immaterial amount on implementation. The Society intends to continue to apply the IAS 39 hedge accounting standards, in line with the IFRS 9 carve out.

The changes to the basis for calculating impairment provisions result in an increase in the impairment loss provisions held against loans and advances to customers on the date of implementation of IFRS 9.

The calculation of lifetime expected credit losses under IFRS 9 requires significant management judgement, particularly in relation to forward looking macroeconomic scenarios and the determination of significant increases in credit risk since origination. The Society has utilised three macroeconomic scenarios:

- a central scenario aligned to the Society's Corporate Plan;
- a downside scenario as modelled in the Society's risk management process; and
- an upside scenario representing the impact of modest improvements to assumptions used in the central scenario.

The relative weighting of the scenarios is a key area of judgement, and the macro-economic factors having the most significant impact on projected losses are unemployment and house price inflation.

It is currently expected that the initial impact of adoption will be an increase in impairment loss provisions of between £21 million and £26 million over the current IAS 39 provisions of £44 million.

The consequent reduction in total equity attributable to members results in a reduction in the Society's CET1 ratio at 1 January 2018 from 14.5% to between 14.3% and 14.4%, as well as a reduction in the CRR leverage ratio from 5.0% to 4.9%. These impacts do not take into account transitional arrangements, agreed by regulators. The Society intends to utilise these arrangements, which add back to CET1 capital resources a proportion of additional impairment provisions arising as a result of the adoption of IFRS 9.

These impacts are based on accounting policies, assumptions and judgements which may be subject to change prior to the finalisation of the Group's Financial Statements for the year ended 31 December 2018.

The Society does not intend to restate comparative figures in its 2018 Annual Report and Accounts, as permitted by the standard.

(b) Accounting convention
The Group prepares its accounts under the historical cost convention, except for the valuation of available for sale financial assets, financial assets and liabilities held at fair value through profit or loss, all derivative financial instruments, and certain freehold and long leasehold properties.

(c) Basis of consolidation
The Group accounts consolidate the accounts of Leeds Building Society, its subsidiaries and those entities over which it is deemed to have control, as listed in note 13. Uniform accounting policies are applied throughout the Group. Intercompany transactions are eliminated upon consolidation.

(d) Financial instruments
(i) Classification
Purchases and sales of financial assets are accounted for at settlement date.

In accordance with IAS 39, Financial Instruments: Recognition and Measurement, the financial instruments of the Group have been classified into the following categories:

1. Accounting policies continued

(d) Financial instruments (continued)

(i) Classification (continued)

- Loans and receivables
  The Group's loans and advances to customers and credit institutions are classified as 'loans and receivables', except for a collateral loan which represents a pool of mortgage assets purchased from a third party for which certain, but not all, risks were transferred to the Group. This is held at fair value through profit or loss.
  Loans and receivables are assets initially recorded at fair value plus any attributable costs and then subsequently measured at amortised cost using the effective interest rate method. In accordance with the effective interest rate method, initial costs and fees such as cashbacks, mortgage premia paid on the acquisition of mortgage books, mortgage arrangement fees, valuation fees, procuration fees and mortgage discounts are amortised over the expected life of the mortgage, where they are directly attributable to the mortgage asset.
- At fair value through profit or loss
  These instruments comprise assets and liabilities which have been specifically designated as such at inception and all derivative financial instruments, including embedded derivatives. Any change in the fair value of the instrument is recognised immediately in the Income Statement. Interest income and expense are recognised on an effective interest rate basis.
  A collateral loan to a third party was designated into this category at the date of inception and is held at fair value through profit or loss. This presentation provides more relevant information as it removes a measurement inconsistency that would otherwise arise from measuring assets or liabilities on a different basis. The Group uses this approach for financial assets that are economically hedged but where it is not practical to apply hedge accounting.
- Available for sale
  Available for sale assets are non-derivative financial assets that are not classified into either of the categories above and are initially recorded at fair value plus any attributable costs. Subsequent changes in the fair value of available for sale assets are recognised in equity, except for impairment losses. The Group uses this category for purchased investment securities for which an active market exists.
  The premia and discounts arising from the purchase of available for sale assets are amortised over the period to the maturity date of the security on an effective yield basis.
  The fair values of quoted investments in active markets are based on current bid prices.
- Financial liabilities
  All financial liabilities are initially recorded at fair value less directly attributable transaction costs and subsequently measured at amortised cost using the effective interest method, except for those financial liabilities measured at fair value through profit or loss, for example derivative liabilities.
  The premia and discounts, together with commissions and other costs incurred in the raising of wholesale funds and subordinated liabilities, are amortised over the period to maturity using the effective interest rate method.

(ii) Sale and repurchase agreements
Investments and other securities may be lent or sold subject to a commitment to repurchase them (a 'repo'). Such securities are retained on the Statement of Financial Position when substantially all of the risks and rewards of ownership remain within the Group, and the counterparty liability is included separately on the Statement of Financial Position as appropriate. Where applicable, the difference between sale and repurchase price is accrued over the life of the agreement using the effective interest rate method.

(iii) Derecognition of financial assets and liabilities
Financial assets are only derecognised when the contractual rights to receive cash flows from them have expired or when the Group has transferred substantially all risks and rewards of ownership. The Group has not derecognised the mortgage loans which have been used to secure its issue of debt securities as substantially all the risks and rewards are retained by the Group and the Group retains control of the assets. Financial liabilities are only derecognised when the obligation is discharged, cancelled or has expired. Assets and liabilities that have failed the derecognition test are recognised by the Society and its subsidiaries to reflect intra-group transfer of risks and rewards which are eliminated on consolidation.

(iv) Derivative financial instruments and hedge accounting
Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into, and are subsequently re-measured monthly at their fair value. The need for credit valuation adjustments is considered in the determination of the fair value of derivatives. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

All derivatives are entered into by the Group for the purpose of providing an economic hedge; however certain criteria must be met before the instruments can be allocated to accounting hedge relationships. The Group makes use of accounting fair value hedges to reduce volatility in the Income Statement. If derivatives are not designated as accounting hedges then changes in fair values are recognised immediately in the Income Statement.

A fair value hedge is used to hedge exposures to variability in the fair value of financial assets and liabilities, such as fixed rate loans and investment products. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the Income Statement together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. If the hedge no longer meets the criteria for hedge accounting, the relationship is de-designated and the adjustment to the carrying amount of the hedged item is amortised to the Income Statement over the period to maturity. The Group did not enter into any cash flow hedge relationships during the year.

1. Accounting policies continued

(e) Impairment of financial assets

Impairment losses are recognised in the Income Statement at the point at which they are incurred. An impairment provision is maintained between the point at which the loss is incurred and the point at which it is realised, unless there is objective evidence that the loss should be reversed.

(i) **Impairment of loans and advances to customers**

The Group assesses its loans and advances to customers for objective evidence of impairment at each Statement of Financial Position date. An impairment loss is recognised if, and only if, there is a loss event (or events) that has occurred after initial recognition and before the Statement of Financial Position date, which has a reliably measurable impact on the estimated future cash flows.

If evidence of impairment is identified, a provision is made to reduce the value of the impaired asset to the amount that is expected to be recovered based upon objective evidence of estimated future cash flows. In assessing the recoverable amount, factors taken into consideration include the time and cost incurred to possess and sell, and the value of the security based on the latest available information.

Impairment is categorised as either individual impairment (where individual assets have been assessed for loss) or collective impairment (where losses are assessed as being present in a portfolio of loans, but cannot be attributed to individual accounts).

Individual assessments are performed for all mortgage loans in default or possession and where there is objective evidence that not all cash flows will be received. Based upon these assessments an individual impairment provision is made against these assets as appropriate.

In addition, a collective impairment provision is made against those loans and advances to customers where objective evidence, including forbearance measures, indicates that it is likely that, for some assets, a loss event has occurred and losses may ultimately be realised. The assets are allocated into categories based on similar characteristics and the impairment value is calculated by applying factors to each loan. These factors take into account the Group's experience of default and delinquency rates, loss emergence periods, regional property price movements, and adjustments to allow for forced sale values.

Forbearance strategies exercised by the Group include mortgage term extensions, transfer of mortgages (in full or in part) to an interest only product and capitalisation of arrears once the customer has demonstrated six months of consecutive contractual payments. These strategies are only adopted where they will not give rise to customer detriment. Note 33 provides further information on the forbearance strategy.

If a loss is ultimately realised, it is written off against the provision previously made. Any subsequent recoveries are recognised directly in the Income Statement as they arise.

(ii) **Impairment of investment securities**

The Group assesses its investment securities for objective evidence of impairment at each Statement of Financial Position date. This assessment includes consideration of any financial difficulties of the issuer, the nature of any supporting assets (if appropriate), any credit ratings changes and the adherence to covenants, including making scheduled payments.

An impairment loss is recognised if, and only if, there is a loss event (or events) that has occurred after initial recognition and before the Statement of Financial Position date, which has a reliably measurable impact on the estimated future cash flows.

Where the Group determines that there is objective evidence of impairment, or that trigger events exist at the Statement of Financial Position date, then, in the case of available for sale instruments, the amount of the cumulative loss that had been recognised directly in reserves that relates to the impairment is removed from reserves and recognised in the Income Statement. If in a subsequent period, the fair value of a debt instrument classified as available for sale increases, and the increase can be related to an event occurring after the impairment loss was recognised through the Income Statement, the impairment loss is reversed, with the amount of the reversal recognised through the Income Statement. For assets classified as loans and receivables, the loss, and any adjustment to or reversal of this amount, is recognised immediately in the Income Statement.

(f) Interest income and expense

Interest income and expense on all financial instruments are recognised in interest receivable or payable in the Income Statement.

Interest income and expense on financial assets and liabilities held at amortised cost are measured using the effective interest rate method. The effective interest rate method is a method of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts over the expected life of the financial instrument.

Specifically, for mortgage assets, the effect of this policy is to spread the impact of discounts, cashbacks, arrangement and valuation fees, and costs directly attributable and incremental to setting up the loan, over the expected life of the mortgage. Expected lives are reassessed at each Statement of Financial Position date and any changes are reflected in the effective interest rate models, resulting in an immediate gain or loss in the Income Statement.

(g) Fees and commission receivable

Fees and commissions are generally recognised on an accruals basis in line with the delivery of the service.

Fees integral to the loan yield are included within interest income and included in the effective interest rate calculation as set out above.

Commission received by the Group from third parties may be required to be repaid at a later date if certain policies are cancelled. A provision is included in the accounts to cover the estimate of the amount of clawbacks that will become payable in the future, based on products that have been sold and commissions received prior to the year end.

1. Accounting policies continued

(h) Intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance. An intangible asset is recognised to the extent it is probable that expected future economic benefits will flow from it and the costs can be measured reliably. The Group has purchased software licences and certain IT development services, which qualify for recognition as intangible assets. Amortisation of such assets is charged to the Income Statement on a straight line basis over the useful life of the asset once it is brought into use. The useful life of such assets is deemed to be five years.

Intangible assets are reviewed for impairment at each Statement of Financial Position date or when there is an indication of impairment. Impairment occurs when the economic benefits arising from the asset are lower than its carrying amount. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss. The recoverable amount is the higher of fair value less costs of disposal and value in use, calculated on the discounted cash flow method. Any impairment in the value of these assets is recognised immediately as an expense in the Income Statement.

(i) Property, plant and equipment

Freehold and long leasehold properties are revalued every three years by an independent firm of valuers. The fair value of the properties is determined from market based evidence.

No provision is made for depreciation of freehold and long leasehold properties as in the opinion of the Board, their residual value will not be materially different to book value.

All other items of property, plant and equipment are initially recognised at cost and then depreciated. Depreciation is calculated on a straight line method, to write down the cost of such assets to their residual values over their estimated useful lives as follows:

Short leasehold properties	Unexpired lease term
Improvements to properties	8 to 10 years
Office and computer equipment	3 to 5 years
Motor vehicles	3 to 5 years (reducing balance basis)

Property, plant and equipment are reviewed annually for indications of impairment. Impairment losses are recognised immediately as an expense in the Income Statement.

(j) Retirement benefits

Payments to defined contribution retirement benefit schemes are charged as an expense as they fall due.

For defined benefit retirement benefit schemes, the cost of providing benefits is determined using the projected unit method, with actuarial valuations updated at each year end. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the Income Statement and presented in the Statement of Comprehensive Income.

The retirement benefit surplus or obligations recognised in the Statement of Financial Position represents the fair value of scheme assets less the present value of the defined benefit obligation. Where the fair value of the assets exceeds the present value of the liabilities, the surplus that may be recorded on the Statement of Financial Position is capped at the asset ceiling. This is the total of the future economic benefits that will flow to the Group as a result of the surplus.

(k) Leases

Rentals under operating leases are charged to administrative expenses on a straight line basis over the life of the lease.

(l) Tax

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantially enacted by the Statement of Financial Position date. Tax on the profits for the period comprises current tax and deferred tax. Tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in reserves, in which case it is recognised in reserves. Current tax is the expected tax payable on the taxable income for the year, using tax rates applicable at the Statement of Financial Position date and any adjustment to tax payable in respect of previous years.

Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available, against which deductible temporary differences can be utilised. Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

(m) Foreign currency

Assets and liabilities denominated in foreign currencies are translated into sterling at the appropriate rates of exchange prevailing at the Statement of Financial Position date and exchange differences are included in the Income Statement. All foreign currency income and expense is translated into sterling at the rate of exchange on the day of receipt or payment.

(n) Segmental reporting

The Group's chief operating decision maker has been identified as the Chief Executive Officer, who reviews the Group's internal reporting and is responsible for all significant decisions. The Group's policy on segmental reporting has been updated during the year to better reflect the information reported to the chief operating decision maker for the purposes of resource allocation and assessment of performance. The Group has now determined that it has one reportable segment as the Chief Executive Officer reviews performance and makes decisions on the Group as a whole. Therefore, no separate segmental reporting note has been provided.

2. Critical accounting estimates and judgements

The preparation of these financial statements involves making judgements in the application of accounting policies which affect the amounts recognised in the financial statements. In addition, the Group makes estimates and assumptions which could affect the reported amounts of assets and liabilities in the next financial year and beyond.

The Group reviews all critical judgements and estimates on a regular basis, including approval by the Audit Committee as explained on pages 60 to 66, to ensure that these remain appropriate. The critical judgements and estimates which have a significant impact on the financial statements of the Group are described below.

(a) Critical judgements

(i) Intangible assets

The Group applies judgement as to whether purchased software or IT development services qualify for recognition as intangible assets. For an asset to be recognised under IAS 38 it must be probable that future economic benefits will flow from the asset and the cost of the asset must be able to be measured reliably. For each significant project undertaken by the Group, an assessment of future benefits is performed by the relevant business area and reviewed in accordance with the agreed governance process.

Intangible assets are reviewed annually for indications of impairment, which includes the application of judgement as to whether it is probable that future economic benefits will be realised from the asset, and whether the value in use of the asset is in excess of the carrying value (see note 14 for further information).

(b) Accounting estimates and assumptions

(i) Impairment losses on loans and advances to customers

The calculation of impairment losses on loans and advances to customers uses a combination of statistical modelling and management estimates in relation to the probability and size of potential losses.

The probability of a loan defaulting and resulting in a sale of possessed property is estimated based on historical loss experience for assets with similar credit risk characteristics.

The size of potential losses is estimated based on an assumption as to the timing of any possession sale and an estimate of sale proceeds. Sale proceeds are derived using the latest property valuation available, adjusted for estimated future price movements and an estimated forced sale discount, based on historic experience.

There are interactions between the assumptions used such that no single assumption would move independently of the others, but the table below sets out the sensitivity of the impairment loss provision to movements in individual assumptions assuming all other assumptions remain unchanged.

At 31 December 2017 residential impairment loss provisions are £23.8m (2016: £26.0m). The potential increase due to changes in assumptions is:

	Group & Society 2017 £M	Group & Society 2016 £M
5% increase in the probability of a loan defaulting	**0.3**	0.4
5% reduction in expected house prices	**0.7**	0.8
5% increase in forced sale discount	**0.7**	0.8

At 31 December 2017 commercial impairment provisions are £17.2m (2016: £25.7m). The potential increase due to changes in assumptions is:

	Group & Society 2017 £M	Group & Society 2016 £M
5% increase in the probability of a loan defaulting	**1.2**	2.4
5% reduction in expected property prices	**1.5**	2.1

(ii) Retirement benefit surplus / obligation

The Income Statement charge and Statement of Financial Position surplus or obligation of the defined benefit pension scheme are calculated in accordance with the advice of a qualified actuary. Calculations are based on a number of assumptions about the future which will impact the level of scheme liabilities and the performance of scheme assets. The most significant assumptions used are detailed in note 26.

Changes to any of the assumptions could have an impact on the level of actuarial gains and losses recognised in the Statements of Comprehensive Income and the Statement of Financial Position balance. The most significant impacts arise from the rate used to discount scheme liabilities and the rate of inflation, with the impact of changes to those assumptions detailed in note 26.

2. Critical accounting estimates and judgements continued

(iii) Fair values of complex financial instruments

Fair values of financial instruments are determined in accordance with the valuation hierarchy as set out in note 35. For those instruments classed as Level 3, the valuation is in part based on unobservable inputs and therefore requires an element of estimation.

The fair value of the collateral loan to a third party is calculated with reference to the valuation of the associated derivatives. This valuation is reliant on an estimate of the balance of the underlying mortgages, which is driven by estimates of future mortality rates and mortgage prepayment rates. At 31 December 2017 the book value of the collateral loan was £247.7m (2016: £251.9m) of which £64.9m (2016: £69.8m) related to the fair value uplift referred to above. Any movement in the valuation of the collateral loan is largely offset by an opposite movement in the valuation of the associated derivative, therefore there is no material Income Statement impact of any changes to assumptions.

The notional value of certain securitisation interest rate swaps tracks the balance of a portfolio of loans and advances to customers. The valuation of those swaps is therefore dependant on an estimate of the future balance of the portfolio, driven by estimated mortgage prepayment rates. Since these estimates are not developed by the Society for the purpose of these swap valuations, the Society has taken advantage of the permitted exemption to not disclose sensitivities to these estimates.

3. Interest receivable and similar income

	Group 2017 £M	Group 2016 £M	**Society 2017 £M**	Society 2016 £M
On loans fully secured on residential property	**435.5**	433.7	**435.5**	433.7
On other loans and advances to customers	**16.4**	17.6	**16.4**	17.6
On investment securities	**8.2**	10.8	**13.1**	17.2
On other liquid assets	**5.1**	4.3	**5.1**	4.3
Net expense on financial instruments	**(52.0)**	(60.1)	**(67.4)**	(85.6)
Total interest receivable	**413.2**	406.3	**402.7**	387.2
Net expense on instruments held at fair value through profit or loss	**(38.8)**	(48.2)	**(42.6)**	(54.3)
Interest receivable on instruments not held at fair value through profit or loss	**452.0**	454.5	**445.3**	441.5
Included in the above is:				
Interest receivable on impaired financial assets	**3.0**	4.1	**3.0**	4.1

4. Interest payable and similar charges

	Group 2017 £M	Group 2016 £M	**Society 2017 £M**	Society 2016 £M
On shares held by individuals	**159.4**	171.8	**159.4**	171.8
On deposits and other borrowings	**67.0**	59.4	**56.9**	43.2
On subscribed capital	**3.3**	3.3	**3.3**	3.3
Net income on financial instruments	**(29.7)**	(30.0)	**(30.9)**	(29.9)
Total interest payable	**200.0**	204.5	**188.7**	188.4
Net income on instruments held at fair value through profit and loss	**(29.7)**	(30.0)	**(30.9)**	(29.9)
Interest payable on instruments not held at fair value through profit and loss	**229.7**	234.5	**219.6**	218.3

Year ended
31 December 2017 **Continued**

5. Fair value gains less losses from financial instruments

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Change in fair value of financial assets designated at fair value through profit and loss	**(14.3)**	17.6	**(14.3)**	17.6
Change in fair value of financial liabilities designated at fair value through profit and loss	**15.4**	(22.0)	**14.0**	(20.4)
Change in fair value of derivatives in designated fair value hedge accounting relationships	**17.0**	(11.9)	**33.2**	(15.5)
Adjustment to hedged items in designated fair value hedge accounting relationships	**(4.8)**	7.6	**(18.8)**	12.7
Change in fair value of cross currency swap net of retranslation on matched Euro liabilities	**(14.6)**	7.4	**(2.2)**	6.9
Total fair value gains and losses from financial instruments	**(1.3)**	(1.3)	**11.9**	1.3
The net position on the cross currency swaps includes:				
Fair value gain on cross currency swaps	**125.6**	91.0	**58.6**	36.4
Exchange loss on retranslation of matched Euro liabilities	**(133.9)**	(86.1)	**(57.6)**	(33.2)

The fair value accounting volatility loss of £1.3m (2016: £1.3m loss) represents the net fair value movement on derivatives designated as hedging instruments, matched hedged items and derivatives matched on an economic basis. Some accounting volatility arises on these items due to accounting ineffectiveness on designated hedges, or because hedge accounting could not be applied on certain items. For further information refer to notes 34 and 35.

The cross currency swaps were entered into to reduce the exchange rate risk from funding in foreign currency; however they are not in accounting hedge relationships.

6. Administrative expenses

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Staff costs				
Wages and salaries	**47.4**	44.9	**47.4**	44.8
Social security costs	**4.5**	4.4	**4.5**	4.4
Other pension costs	**4.8**	4.6	**4.8**	4.6
Remuneration of auditor (see below)	**0.4**	0.4	**0.4**	0.4
Other administrative expenses	**35.4**	34.4	**35.4**	34.3
Total administrative expenses	**92.5**	88.7	**92.5**	88.5

There are 28 directors, senior management and members of staff whose actions have a material impact on the risk profile of the Group, with fixed remuneration of £4.5m and variable remuneration of £1.4m (2016: 27 individuals, £4.3m and £1.3m).

The analysis of auditor's remuneration is as follows:

	Group & Society 2017 £000	Group & Society 2016 £000
Fees payable to the Society's auditor for the audit of the Society's annual accounts	**247.2**	247.4
Fees payable to the Society's auditor for the audit of the Society's subsidiaries	**42.5**	47.8
Total audit fees	**289.7**	295.2
Assurance services	**156.8**	152.3
Total non-audit fees	**156.8**	152.3
Fees payable to the Society's auditor and its associates in respect of associated pension schemes	**6.6**	6.5

The above figures relating to auditor's remuneration exclude value added tax.

Notes to the Accounts

Year ended
31 December 2017 **Continued**

7. Staff numbers

The average number of persons employed during the year was as follows:

	Group & Society	
	2017 Number	2016 Number
Central administration	**1,094**	1,001
Branches	**333**	363
Total average number of persons employed	**1,427**	1,364

At 31 December 2017, the total number of persons employed by the Group and the Society was 1,403 (2016:1,420).

8. Impairment on loans and advances to customers

2017

Group & Society

	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2017				
Collective impairment	11.9	5.6	–	17.5
Individual impairment	14.1	20.1	2.5	36.7
Opening impairment	26.0	25.7	2.5	54.2
Income Statement				
Charge / (release) for the year				
Collective impairment	(3.9)	(2.0)	–	(5.9)
Individual impairment	6.4	(4.9)	–	1.5
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(1.1)	–	–	(1.1)
Total Income Statement losses / (gains)	1.4	(6.9)	–	(5.5)
Amount written off during the year				
Individual impairment	(3.6)	(1.6)	–	(5.2)
At 31 December 2017				
Collective impairment	8.0	3.6	–	11.6
Individual impairment	15.8	13.6	2.5	31.9
Closing impairment	23.8	17.2	2.5	43.5

Year ended
31 December 2017 **Continued**

8. Impairment losses on loans and advances to customers continued

2016
Group & Society

	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
At 1 January 2016				
Collective impairment	10.8	10.7	–	21.5
Individual impairment	15.1	25.0	2.5	42.6
Opening impairment	25.9	35.7	2.5	64.1
Income Statement				
Charge / (release) for the year				
Collective impairment	1.1	(5.1)	–	(4.0)
Individual impairment	4.7	(0.7)	–	4.0
Adjustments to impairment losses for bad and doubtful debts resulting from recoveries during the year	(0.9)	–	–	(0.9)
Total Income Statement losses / (gains)	4.9	(5.8)	–	(0.9)
Amount written off during the year				
Individual impairment	(4.8)	(4.2)	–	(9.0)
At 31 December 2016				
Collective impairment	11.9	5.6	–	17.5
Individual impairment	14.1	20.1	2.5	36.7
Closing impairment	26.0	25.7	2.5	54.2

Year ended
31 December 2017 **Continued**

9. Tax expense

	Group 2017 £M	Group 2016 £M	**Society 2017 £M**	Society 2016 £M
Analysis of charge in the year				
Current tax				
UK corporation tax on profits for the year	**31.7**	31.2	**31.7**	31.2
Adjustments in respect of previous years	**1.2**	0.3	**1.2**	0.3
Total current tax	**32.9**	31.5	**32.9**	31.5
Deferred tax				
Origination and reversal of timing differences	**0.1**	(0.6)	**(0.1)**	–
Adjustments in respect of previous years	**(0.1)**	(0.3)	**(0.1)**	(0.3)
Total deferred tax	**–**	(0.9)	**(0.2)**	(0.3)
Tax on profit on ordinary activities	**32.9**	30.6	**32.7**	31.2
Factors affecting current tax charge for the year:				
Profit on ordinary activities before tax	**120.9**	116.6	**133.0**	116.1
Profit on ordinary activities multiplied by standard rate of corporate tax in the UK of 19.25% (2016: 20%)	**23.3**	23.3	**25.6**	23.2
Effects of:				
Expenses not deductible for tax purposes	**0.6**	0.3	**0.6**	0.3
Adjustment in respect of prior years	**1.2**	–	**1.2**	–
Rate change	**0.1**	(0.3)	**–**	(0.2)
Banking surcharge	**7.7**	7.4	**7.7**	7.4
Income not taxable	**–**	(0.1)	**(2.4)**	0.5
	32.9	30.6	**32.7**	31.2

The standard rate of corporation tax applicable to the Group for the year ended 31 December 2017 was 19.25% (2016: 20%). Reductions in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and to 18% (effective 1 April 2020) were substantively enacted on 26 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. The Finance (No. 2) Act 2015 introduced an additional surcharge of 8% on banking profits above a £25m threshold (including those of building societies) from 1 January 2016.

The deferred tax balances have been calculated at a rate of 25% (inclusive of the 8% banking levy), as it is expected that these balances will mostly reverse after 1 April 2020.

10. Cash in hand and balances with the Bank of England

	Group 2017 £M	Group 2016 £M	**Society 2017 £M**	Society 2016 £M
Cash in hand	**2.1**	2.0	**2.1**	2.0
Balances with the Bank of England	**1,755.5**	936.9	**1,755.5**	936.9
Included in cash and cash equivalents (see note 24)	**1,757.6**	938.9	**1,757.6**	938.9

Balances with the Bank of England do not include mandatory reserve deposits of £23.4m (2016: £20.8m) which are not available for use in the Group's day to day operations. Such deposits are included within loans and advances to credit institutions in the Statements of Financial Position.

Year ended
31 December 2017 **Continued**

11. Loans and advances to customers

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Loans and receivables				
Loans fully secured on residential property	**14,932.0**	13,081.9	**14,932.0**	13,081.9
Other loans				
Loans fully secured on land	**71.6**	125.3	**71.6**	125.3
Other loans	**2.5**	2.5	**2.5**	2.5
Total loans and receivables	**15,006.1**	13,209.7	**15,006.1**	13,209.7
At fair value through profit or loss				
Loans fully secured on residential property	**0.2**	0.2	**0.2**	0.2
Other loans	**247.7**	251.9	**247.7**	251.9
Total loans at fair value through profit or loss	**247.9**	252.1	**247.9**	252.1
Less:				
Impairment (see note 8)	**(43.5)**	(54.2)	**(43.5)**	(54.2)
Total loans and advances to customers				
Loans fully secured on residential property	**14,908.4**	13,056.1	**14,908.4**	13,056.1
Other loans	**302.1**	351.5	**302.1**	351.5
Total loans and advances to customers	**15,210.5**	13,407.6	**15,210.5**	13,407.6

The Group has a number of residential mortgage portfolios purchased from third parties. The Group assumed certain, but not all, risks arising from these loans, and as a consequence these residential mortgages have been recognised as a collateral loan to a third party within other loans at fair value through profit or loss. The net fair value movement on loans and advances, which are designated as fair value through profit or loss, was a loss of £4.9m (2016: £16.0m gain) for both the Group and Society.

Loans and advances to customers, for both the Group and Society, include £3,080.7m (2016: £2,708.1m) of loans which have been ringfenced from the Society for its associated secured funding vehicles.

The following transfers have been made:

2017	**Covered Bonds LLP £M**	**Albion No. 2 Plc £M**	**Albion No. 3 Plc £M**	**Guildford No. 1 Plc £M**	**Total £M**
Loans and advances transferred from the Society to securitisation vehicles	**2,463.1**	**–**	**165.2**	**452.4**	**3,080.7**
Loan notes issued by securitisation vehicles	**1,658.3**	**–**	**182.8**	**474.2**	**2,315.3**

2016	Covered Bonds LLP £M	Albion No. 2 Plc £M	Albion No. 3 Plc £M	Guildford No. 1 Plc £M	Total £M
Loans and advances transferred from the Society to securitisation vehicles	1,842.4	95.7	220.2	549.8	2,708.1
Loan notes issued by securitisation vehicles	1,217.8	107.6	256.2	569.9	2,151.5

The covered bonds and residential mortgage backed securities issued have been used to secure long term funding from other counterparties. The loans are retained in the Society's Statement of Financial Position as the Society continues to control the loans and substantially retains the risks and rewards relating to them.

12. Investment securities

	Group 2017 £M	Group 2016 £M	**Society 2017 £M**	Society 2016 £M
Debt securities				
Listed	**778.7**	777.8	**1,167.8**	1,254.1
Unlisted	**–**	–	**138.4**	192.6
Total investment securities	**778.7**	777.8	**1,306.2**	1,446.7

Investment securities held by the Group decreased by £4.5m in 2017 (2016: increased by £6.8m) due to changes in fair value. In addition to those securities held by the Group, the Society has purchased investment securities issued by other Group entities. Total investment securities held by the Society decreased by £4.5m in 2017 (2016: increased by £6.8m) due to changes in fair value. This movement was recorded in equity. No impairment provisions have been made against investment securities during the year, nor were there any provisions held as at 31 December 2017 (2016: nil).

	Available for sale £M	**Loans and receivables £M**	**Total £M**
2017			
Group			
At 1 January 2017	**753.7**	**24.1**	**777.8**
Additions	**627.7**	**–**	**627.7**
Disposals (sale and redemption)	**(613.4)**	**(8.9)**	**(622.3)**
Change in fair value	**(5.0)**	**0.5**	**(4.5)**
At 31 December 2017	**763.0**	**15.7**	**778.7**

	Available for sale £M	Loans and receivables £M	Total £M
2016			
Group			
At 1 January 2016	821.1	28.2	849.3
Additions	695.7	–	695.7
Disposals (sale and redemption)	(769.6)	(4.4)	(774.0)
Change in fair value	6.5	0.3	6.8
At 31 December 2016	753.7	24.1	777.8

	Available for sale £M	**Loans and receivables £M**	**Total £M**
2017			
Society			
At 1 January 2017	**1,422.6**	**24.1**	**1,446.7**
Additions	**627.7**	**–**	**627.7**
Disposals (sale and redemption)	**(754.8)**	**(8.9)**	**(763.7)**
Change in fair value	**(5.0)**	**0.5**	**(4.5)**
At 31 December 2017	**1,290.5**	**15.7**	**1,306.2**

12. Investment securities continued

	Available for sale £M	Loans and receivables £M	Total £M
2016 Society			
At 1 January 2016	1,655.2	28.2	1,683.4
Additions	695.7	–	695.7
Disposals (sale and redemption)	(934.8)	(4.4)	(939.2)
Change in fair value	6.5	0.3	6.8
At 31 December 2016	1,422.6	24.1	1,446.7

As permitted by the amendment to IAS 39 issued by the International Accounting Standards Board in October 2008, the Society has reclassified (from 1 July 2008) certain mortgage backed securities and floating rate note assets from the available for sale category to the loans and receivables category. The assets were reclassified as the Society considered that, due to adverse conditions in financial markets, the market for the sale and purchase of mortgage backed securities and floating rate notes had become inactive. This was evidenced by significant fluctuations in the quoted market value of these instruments and that these instruments were no longer being actively traded. The market value of the assets reclassified on 1 July 2008 was £828m, which included £15.8m fair value losses recognised during the period directly in reserves. The carrying value of the remaining assets at 31 December 2017 was £15.7m (2016: £24.1m), and this compares to a market value of £15.9m (2016: £22.6m).

The fair value gain that would have been recorded directly in reserves if the assets had not been reclassified was £0.4m (2016: £0.2m gain). The net loss, after deferred tax, of £0.9m (2016: loss of £1.5m) previously recognised in the available for sale reserve is released to profit or loss as part of the effective interest rate based on the maturity profile of the underlying instruments. The weighted average interest rate on the mortgage backed securities and floating rate note assets was 1.4% (2016: 1.5%).

At 31 December 2017, no investment securities were pledged as collateral under sale and repurchase agreements (2016: none).

13. Investments in subsidiary undertakings

	Society 2017 £M	Society 2016 £M
a) Shares held in subsidiary undertakings		
Cost		
At 1 January	–	–
Additions	**3.8**	–
At 31 December	**3.8**	–
b) Loans to subsidiary undertakings		
Cost		
At 1 January	**14.5**	40.4
Acquisition of subsidiary	**20.0**	–
Net movement during the year	**21.4**	(25.7)
Impairment of loan to Headrow Commercial Property Services Ltd	**–**	(0.2)
At 31 December	**55.9**	14.5
Total investments in subsidiary undertakings	**59.7**	14.5

Year ended
31 December 2017 **Continued**

13. Investments in subsidiary undertakings continued

(c) Interest in subsidiary undertakings

The Society holds the following interests in subsidiary undertakings, all of which are incorporated in the United Kingdom and registered in England, except where noted below.

Name	Major activities	Class of shares held	Interest of Society	Address
Leeds Financial Services Limited	Non-trading	Ordinary £1 shares	100%	105 Albion Street, Leeds LS1 5AS
Leeds Mortgage Funding Limited	Provision of mortgage finance	Ordinary £1 shares	100%	105 Albion Street, Leeds LS1 5AS
Ravenstone Limited (registered in the Isle of Man)	Property holding company	Ordinary £1 shares	100%	Jubilee Buildings, Victoria Street, Douglas, Isle of Man IM1 2SH
Leeds Building Society Covered Bonds LLP	Provision of mortgage assets and guarantor of covered bonds	*	*	105 Albion Street, Leeds LS1 5AS
Leeds Covered Bonds Designated Member (No. 1) Limited	First designated member of Leeds Building Society Covered Bonds LLP	*	*	35 Great St. Helen's, London EC3A 6AP
Leeds Covered Bonds Designated (No. 2) Limited	Second designated member of Leeds Building Society Covered Bonds LLP	*	*	35 Great St. Helen's, London EC3A 6AP
Leeds Covered Bonds Holdings Limited	Holding company to both Leeds Covered Bonds Designated Member (No. 1) & (No. 2) Limited	*	*	35 Great St. Helen's, London EC3A 6AP
Albion No. 2 plc	Provision of residential mortgage backed securities	*	*	35 Great St. Helen's, London EC3A 6AP
Albion No. 2 Holdings Limited	Holding company to Albion No. 2 plc	*	*	35 Great St. Helen's, London EC3A 6AP
Albion No. 3 plc	Provision of residential mortgage backed securities	*	*	35 Great St. Helen's, London EC3A 6AP
Albion No. 3 Holdings Limited	Holding company to Albion No. 3 plc	*	*	35 Great St. Helen's, London EC3A 6AP
Guildford No. 1 plc	Provision of residential mortgage backed securities	*	*	Third Floor, 1 King's Arms Yard, London EC2R 7AF
Guildford No. 1 Holdings Limited	Holding company to Guildford No. 1 plc	*	*	Third Floor, 1 King's Arms Yard, London EC2R 7AF

* The Society's interest is equal to being a 100% owned subsidiary as these entities pass the test of control under IFRS 10. Consequently they have been consolidated in the Group accounts in accordance with IFRS 10 Consolidated Financial Statements. Although the Society does not legally own these entities, it is deemed to control them, as it has power over the activities undertaken by the subsidiaries through the group management and operational structures in place, and it has exposure to variable returns through the purchase of loan notes, deferred consideration and intragroup loans.

In 2017 the Society impaired £nil of its intragroup debt (2016: impaired £0.2m of its debt with Headrow Commercial Property Services Limited; Headrow Commercial Property Services Limited was liquidated in April 2017).

The Society received £1,690 in dividends on the liquidation of Headrow Commercial Property Services Limited during 2017 (2016: £nil).

Notes to the Accounts

Year ended
31 December 2017 **Continued**

13. Investments in subsidiary undertakings continued

(d) Acquisition of subsidiary undertaking

On 22 December 2017, the Society acquired 100% of the issued share capital of Ravenstone Limited, a company registered in the Isle of Man. The company owns 100% of a freehold office property located in Leeds City Centre, which is intended to become the new head office for the Society. Total consideration, which was settled in cash, was £23.8m. Of this, £20.0m was paid to Ravenstone as an intragroup loan in order to settle its loans to other companies within the vendor's group of companies.

The fair value of the assets acquired is concentrated in a single asset (namely the freehold property) and therefore the acquisition has not been treated as a business combination under IFRS 3 – Business Combinations since the acquired company is not classified as a business.

The total consideration paid has therefore been attributed to the fair value of the freehold property within the financial statements of the Group.

No amounts are included in the consolidated Income Statement in respect of Ravenstone Limited for the year ended 31 December 2017.

14. Intangible assets

2017 Group & Society	**Purchased software £M**	**Development costs £M**	**Total £M**
Cost			
At 1 January 2017	**2.2**	**1.9**	**4.1**
Additions	**–**	**8.4**	**8.4**
At 31 December 2017	**2.2**	**10.3**	**12.5**
Amortisation and impairment			
At 1 January 2017	**0.8**	**0.3**	**1.1**
Amortisation charged in the year	**0.4**	**0.2**	**0.6**
Impairment charged in the year	**–**	**5.6**	**5.6**
At 31 December 2017	**1.2**	**6.1**	**7.3**
Net book value			
At 31 December 2017	**1.0**	**4.2**	**5.2**

2016 Group & Society	Purchased software £M	Development costs £M	Total £M
Cost			
At 1 January 2016	2.2	1.7	3.9
Additions	–	0.2	0.2
At 31 December 2016	2.2	1.9	4.1
Amortisation and impairment			
At 1 January 2016	0.4	0.1	0.5
Amortisation charged in the year	0.4	0.2	0.6
Impairment charged in the year	–	–	–
At 31 December 2016	0.8	0.3	1.1
Net book value			
At 31 December 2016	1.4	1.6	3.0

During 2017 the Group continued its programme of works that met the definition of an intangible asset. This included software licences and certain IT development costs. Amortisation of such assets is charged to the Income Statement on a straight line basis over the useful life of the asset once it is brought into use. The useful life of such assets is deemed to be five years.

Intangible assets are reviewed annually for indications of impairment. This review includes an assessment of whether it is probable that future economic benefits will be realised from the asset, and whether the value in use of the asset is in excess of the carrying value. In 2017 impairment of £5.6m (2016: £nil) was recognised in the Income Statement under 'Impairment losses on intangible assets'. This relates to one element of development which was fully impaired having ceased prior to completion.

Year ended
31 December 2017 **Continued**

15. Property, plant and equipment

	Freehold premises £M	Long leasehold premises £M	Short leasehold premises £M	Office and computer equipment £M	Motor vehicles £M	Total £M
2017						
Group & Society						
Cost or valuation						
At 1 January 2017	**20.4**	**0.3**	**1.4**	**39.0**	**–**	**61.1**
Additions	**–**	**–**	**–**	**3.8**	**–**	**3.8**
Acquisition of subsidiary*	**23.8**	**–**	**–**	**–**	**–**	**23.8**
Disposals / reclassifications	**–**	**–**	**–**	**(11.1)**	**–**	**(11.1)**
Decrease in value taken to Other Comprehensive Income	**–**	**–**	**–**	**–**	**–**	**–**
At 31 December 2017	**44.2**	**0.3**	**1.4**	**31.7**	**–**	**77.6**
Depreciation and impairment						
At 1 January 2017	**1.1**	**–**	**1.3**	**28.6**	**–**	**31.0**
Disposals / reclassifications	**–**	**–**	**–**	**(11.1)**	**–**	**(11.1)**
Depreciation charged in the year	**–**	**–**	**–**	**2.4**	**–**	**2.4**
Impairment charged in the year	**–**	**–**	**–**	**0.9**	**–**	**0.9**
At 31 December 2017	**1.1**	**–**	**1.3**	**20.8**	**–**	**23.2**
Net book value						
At 31 December 2017	**43.1**	**0.3**	**0.1**	**10.9**	**–**	**54.4**

	Freehold premises £M	Long leasehold premises £M	Short leasehold premises £M	Office and computer equipment £M	Motor vehicles £M	Total £M
2016						
Group						
Cost or valuation						
At 1 January 2016	22.2	0.3	1.4	36.8	0.1	60.8
Additions	–	–	–	2.8	–	2.8
Disposals / reclassifications	–	–	–	(0.6)	(0.1)	(0.7)
Decrease in value taken to Other Comprehensive Income	(1.8)	–	–	–	–	(1.8)
At 31 December 2016	20.4	0.3	1.4	39.0	–	61.1
Depreciation and impairment						
At 1 January 2016	1.1	–	1.3	26.2	0.1	28.7
Disposals / reclassifications	(0.5)	–	–	(0.2)	(0.1)	(0.8)
Depreciation charged in the year	–	–	–	2.6	–	2.6
Impairment charged in the year	0.5	–	–	–	–	0.5
At 31 December 2016	1.1	–	1.3	28.6	–	31.0
Net book value						
At 31 December 2016	19.3	0.3	0.1	10.4	–	30.1

* See note 13(d)

All of the above property, plant and equipment are held by the Society with the exception of one freehold property with a valuation of £23.8m. The net book value of the Society's property, plant and equipment is £30.6m (2016: £30.1m). The Society's depreciation charge for the year was £2.4m (2016: £2.5m).

15. Property, plant and equipment continued

During 2017 impairment of £0.9m was charged against certain office equipment which will not be required in the new head office. The impairment charge for 2016 relates to freehold premises. In accordance with the Group's accounting policies, an updated valuation was undertaken as at 31 December 2016 by Knight Frank for all freehold and long leasehold premises. The properties will next be revalued at 31 December 2019.

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
The amount of freehold and long leasehold premises (included above at valuation) determined according to the historical cost convention is as follows:				
Freehold premises	**33.5**	9.7	**9.7**	9.7
Long leasehold premises	**0.1**	0.1	**0.1**	0.1
Net book value	**33.6**	9.8	**9.8**	9.8
Land and buildings occupied by the Group and Society for its own activities				
Net book value	**15.9**	18.7	**15.9**	18.7

No equipment, fixtures and vehicles were held under finance leases (2016: none).

16. Deferred income tax

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Deferred tax				
At 1 January 2016	**(0.1)**	(1.0)	**(0.2)**	(1.2)
Adjustment to amounts brought forward	**0.1**	(1.3)	**0.1**	(0.1)
Amount recognised directly in equity	**(1.2)**	1.2	**(1.1)**	(0.3)
Income and expenditure movement during the year	**(0.1)**	1.0	**0.1**	1.4
At 31 December 2016	**(1.3)**	(0.1)	**(1.1)**	(0.2)

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Deferred income tax liabilities				
Gain on revaluation	**–**	0.6	**–**	0.6
Pensions and other post-retirement benefits	**–**	–	**–**	–
Other temporary differences	**3.2**	2.1	**2.1**	1.4
Total deferred income tax liabilities	**3.2**	2.7	**2.1**	2.0

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Deferred income tax assets				
Pensions and other post-retirement benefits	**1.5**	2.4	**1.5**	2.4
Other provisions	**0.4**	0.2	**(0.5)**	(0.6)
Total deferred income tax assets	**1.9**	2.6	**1.0**	1.8

Year ended
31 December 2017 **Continued**

17. Other assets, prepayments and accrued income

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Collateral	**194.6**	238.2	**194.6**	238.2
Prepayments	**3.7**	3.4	**3.7**	3.4
Other assets	**11.4**	7.6	**106.2**	90.3
Total other assets, prepayments and accrued income	**209.7**	249.2	**304.5**	331.9

Other assets include £194.6m (2016: £238.2m) owed by credit institutions on cash collateralisation of derivatives.

18. Shares

	Group & Society	
	2017 £M	2016 £M
Held by individuals	**13,063.5**	11,194.2
Other shares	**8.0**	7.9
Total shares	**13,071.5**	11,202.1

19. Amounts owed to other customers

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Amounts owed to subsidiary undertakings	**–**	–	**616.2**	875.3
Other deposits	**254.9**	357.5	**254.9**	357.5
Total amounts owed to other customers	**254.9**	357.5	**871.1**	1,232.8

20. Debt securities in issue

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Certificates of deposit	**72.0**	15.5	**72.0**	15.5
Senior unsecured debt	**924.2**	896.5	**924.2**	896.5
Covered bonds	**1,721.8**	1,276.3	**1,706.6**	1,246.0
Residential mortgage backed securities	**137.7**	282.9	**–**	–
Total debt securities in issue	**2,855.7**	2,471.2	**2,702.8**	2,158.0

The interest rates on debt securities in issue include both fixed and variable rates. The underlying security for the covered bonds and residential mortgage backed securities (RMBS) are certain loans and advances to customers (see note 11 for further detail).

Year ended
31 December 2017 **Continued**

20. Debt securities in issue continued

For the purposes of the Statements of Cash Flows, debt securities in issue are classified as liabilities arising from financing activities, and no other items within the Statements of Financial Position are classified as such. The table below provides a reconciliation of movements in debt securities in issue:

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
At 1 January	2,471.2	2,056.8	2,158.0	1,599.1
Cash flows:				
Net proceeds from issue of debt securities	574.5	450.1	574.5	450.1
Repayments of debt securities in issue	(218.0)	(208.9)	(72.5)	(59.0)
Non cash flows:				
Amortisation of discount on issue	2.3	2.2	2.3	2.2
Foreign exchange movements	51.8	151.3	51.8	151.3
Changes in fair value	(26.1)	19.7	(11.3)	14.3
At 31 December	2,855.7	2,471.2	2,702.8	2,158.0

21. Other liabilities and accruals

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Income tax	–	1.3	–	1.3
Accruals	21.7	16.2	20.9	16.5
Other payables	163.9	139.8	154.4	137.9
Total other liabilities and accruals	185.6	157.3	175.3	155.7

Included within other payables is a liability for financial guarantee contracts of £3.6m (2016: £3.6m).

Other payables includes £108.0m (2016: £90.0m) owed to credit institutions on cash collateralisation of derivatives.

22. Provisions for liabilities and charges

2017	FSCS Levy £M	Customer redress and related provisions £M	Commission clawback £M	Other provisions £M	Total £M
Group & Society					
At 1 January 2017	2.5	2.5	0.3	–	5.3
Amounts paid during the year	(1.7)	(0.8)	–	–	(2.5)
Provision charge in the year	0.2	3.2	–	0.2	3.6
At 31 December 2017	1.0	4.9	0.3	0.2	6.4

Year ended
31 December 2017 **Continued**

22. Provisions for liabilities and charges continued

2016	FSCS Levy £M	Customer redress and related provisions £M	Commission clawback £M	Other provisions £M	Total £M
Group & Society					
At 1 January 2016	2.8	3.3	0.3	–	6.4
Amounts paid during the year	(2.6)	(2.4)	–	–	(5.0)
Provision charge in the year	2.3	1.6	–	–	3.9
At 31 December 2016	2.5	2.5	0.3	–	5.3

Financial Services Compensation Scheme (FSCS) levy

The levy represents the estimated amount of interest payable under the FSCS for the 2017/18 scheme year, which runs from April 2017 to March 2018, and is calculated with reference to the protected deposits held at 31 December 2016. Based on IFRIC 21 'Levies' this amount was recognised in full at the trigger date, 1 April 2017. Refer to note 25 for the Group's contingent liability in relation to the FSCS as at the Statement of Financial Position date.

Customer redress and related provisions

This provision is made in respect of redress payments to customers. This includes potential claims on payment protection insurance sold by the Group and other fees and premia charged and reflects the expected impact of the claims deadline in 2019 and the Plevin ruling. The charge in the year ended 31 December 2017 included potential costs in relation to one of the Society's third party product providers.

Commission clawback

This provision has been made for the potential clawback of commission on assurance policies sold.

Other provisions

A provision has been made for potential dilapidations on leased premises.

23. Subscribed capital

	Group & Society 2017 £M	Group & Society 2016 £M
13 3/8% permanent interest bearing shares	**25.0**	25.0

The subscribed capital, which is denominated in sterling, was issued for an indeterminate period and is only repayable in the event of the winding up of the Society.

24. Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash and cash equivalents comprise the following balances with less than three months maturity from the date of acquisition.

	Group 2017 £M	Group 2016 £M	Society 2017 £M	Society 2016 £M
Cash in hand and balances with the Bank of England (note 10)	**1,757.6**	938.9	**1,757.6**	938.9
Loans and advances to credit institutions	**194.0**	187.3	**80.9**	66.3
Total cash and cash equivalents	**1,951.6**	1,126.2	**1,838.5**	1,005.2

The Group's loans and advances to credit institutions includes £105.5m (2016: £111.2m) of balances belonging to the Society's securitisation programmes which are not available for general use by the Society.

25. Guarantees and other financial commitments

(a) Financial Services Compensation Scheme

The Group has a contingent liability in respect of contributions to the Financial Services Compensation Scheme provided by the Financial Services and Markets Act 2000. The FSCS provides compensation to depositors in the event that a financial institution is unable to repay amounts due and is funded by contributions from the financial services industry. Following the failure of a number of financial institutions, the FSCS raised borrowings from the UK Government to cover compensation in relation to protected deposits. These borrowings are anticipated to be largely repaid from the realisation of the assets of the failed institutions. During 2017 there was no FSCS specific capital element levied separately as sufficient levies had been paid in the previous years to fund the shortfalls arising. It is possible that capital levies may be required in the event of institutional failures in the future. Interest on the loan made by HM Treasury in respect of failed financial institutions will continue to be accrued based on the known interest cost and the Society's market share as communicated by the FSCS.

(b) Subsidiary undertakings

The Society is obliged under the Building Societies Act 1986 to discharge the liabilities of its subsidiary undertakings to the extent they were incurred before 11 June 1996 and in so far as those bodies are unable to discharge the liabilities out of their own assets.

(c) Capital commitments

The Group has commitments of £0.8m (2016: £9.9m) payable under executory contracts over a period of ten years which relate to the ongoing investment programme. This amount is inclusive of value added tax.

(d) Lease commitments

At 31 December the total undiscounted commitments under non-cancellable operating leases were as set out below:

Group & Society	2017 £M	2016 £M
Land and buildings operating leases		
Commitment expiring:		
Within one year	**1.2**	1.7
Between one and five years inclusive	**3.9**	3.3
After five years	**2.4**	2.7
Total land and buildings operating leases	**7.5**	7.7
Other operating leases		
Commitment expiring:		
Within one year	**6.1**	5.9
Between one and five years inclusive	**22.7**	23.8
After five years	**11.0**	17.8
Total other operating leases	**39.8**	47.5

26. Retirement benefit surplus / obligation

The Group operates both defined benefit and defined contribution schemes. In addition, the Group has, for one individual (2016: one individual) in the UK, an employer funded retirement benefits scheme. The schemes have been accounted for under IAS19, which covers employee benefits.

The defined benefit scheme provides benefits based on final salary for certain employees. The assets of the Scheme are held in a separate trustee-administered fund. Contributions to the defined benefit section are assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The defined benefit section was closed to new entrants from 1 January 2000, and closed to future benefit accrual from 31 December 2014. As at 31 December 2017 there were 337 deferred defined benefit members (2016: 354).

The scheme's adopted and agreed funding target is 100% of its technical provisions. The trustees make annual checks on the funding position of the scheme, to confirm whether or not the scheme is still on track to meet this objective by the end of the set recovery period. The scheme's investment objective is to achieve, over the long term, a return on investments which is at least as high as the long term assumptions made by the trustees in determining the funding of the scheme. The scheme's investment strategy is to hold approximately 30% of assets in equities, with the remainder in a diverse range of investments.

The average duration of the benefit obligation is assumed to be 20 years.

The defined benefit scheme exposes the Group to actuarial risks, as detailed below:

Risk	Impact
Interest rate risk	A decrease in corporate bond yields results in an increase in the present value of the scheme liabilities
Inflation risk	An increase in inflation results in higher benefit increases for scheme members, increasing the scheme's liabilities
Longevity risk	An increase in life expectancies results in a longer benefit payment period which in turn increases the scheme liabilities
Investment market risk	A fall in equity markets would result in a decrease in the scheme's overall assets due to the return-seeking element of the investment strategy

26. Retirement benefit surplus / obligation continued

Actuarial gains and losses are recognised immediately in full through the Statements of Comprehensive Income. The major assumptions used by the Actuary were (in nominal terms):

Group & Society	2017	2016	2015	2014	2013
Rate of increase in salaries*	**–**	–	–	4.80%	5.15%
Rate of increase for pensions in payment* *	**3.00%**	3.05%	3.00%	2.95%	3.20%
Rate of increase for deferred pensions**	**3.00%**	3.05%	3.15%	3.05%	3.40%
Discount rate	**2.40%**	2.55%	3.80%	3.60%	4.45%
Inflation assumption RPI	**3.15%**	3.20%	3.15%	3.05%	3.40%
Inflation assumption CPI	**2.15%**	2.20%	2.15%	2.05%	2.40%

* as the Scheme was closed to future benefit accrual from 31 December 2014 salary-based measures have ceased to apply.
** in excess of any Guaranteed Minimum Pension (GMP) element.

The expected return on the assets has been derived as the weighted average of the expected returns from the main asset class (equities and bonds). The expected return for the asset class reflects a combination of historical performance analysis, the forward looking view of the financial markets (as suggested by yields available), and the views of the investment organisations.

The most significant non-financial assumption is the assumed rate of longevity, which is based on the SAPS tables known as S2PXA (2016: S2PXA), projected in line with members' years of birth. Future improvements in mortality allowed for are in line with the CMI 2016 projection with a 1.25% long term trend. The table below shows the life expectancy assumptions used in the accounting assessments. Pensioner life expectancies are for a member currently aged 63 retiring now. Non-pensioner life expectancies are for a member retiring at age 63 currently aged 43.

Group & Society	2017 Pensioner years	2017 Non-Pensioner years	2016 Pensioner years	2016 Non-Pensioner years	2015 Pensioner years	2015 Non-Pensioner years
Male	**23.9**	**25.4**	23.7	25.1	23.7	25.0
Female	**25.8**	**27.4**	25.8	27.3	25.7	27.2

Reconciliation of funded statement	2017 £M	2016 £M	2015 £M	2014 £M	2013 £M
Present value of pension scheme's liabilities	**(114.2)**	(114.2)	(97.7)	(103.7)	(97.5)
Assets at fair value	**115.2**	111.6	102.8	105.0	94.2
Surplus / (obligation)	**1.0**	(2.6)	5.1	1.3	(3.3)

Group & Society	2017 £M	2016 £M
Net interest cost and expected return	**–**	(0.3)
Administration expenses	**0.4**	0.5
Total cost – defined benefit scheme	**0.4**	0.2

Year ended
31 December 2017 **Continued**

26. Retirement benefit surplus / obligation continued

Amounts recognised in the Statements of Comprehensive Income (SOCI)

Group & Society	2017 £M	2016 £M	2015 £M	2014 £M	2013 £M
Experienced (loss) / gain on pension scheme liabilities	(2.5)	(26.0)	4.2	(13.6)	(7.9)
Percentage of scheme liabilities (%)	2.2%	22.8%	4.3%	13.1%	8.1%
Experienced gain / (loss) on assets	4.5	16.5	(2.1)	6.2	5.6
Percentage of scheme assets (%)	3.9%	14.8%	2.0%	5.9%	5.9%
Total gain / (loss) recognised in SOCI during the year	2.0	(9.5)	2.1	(7.4)	(2.3)

Changes in the present value of the defined benefit obligations are as follows:

Group & Society	2017 £M	2016 £M
At 1 January	114.2	97.7
Interest cost	2.8	3.4
Actuarial losses	2.5	26.0
Benefits paid	(5.3)	(12.9)
At 31 December	114.2	114.2

Changes in the fair value of scheme assets are as follows:

Group & Society	2017 £M	2016 £M
At 1 January	111.6	102.8
Interest income	2.8	3.7
Actuarial gains	4.5	16.5
Contribution by employer	2.0	2.0
Administration expenses	(0.4)	(0.5)
Benefits paid	(5.3)	(12.9)
At 31 December	115.2	111.6

The cumulative amount of actuarial gains and losses recognised in the Statement of Other Comprehensive Income since the date of transition to IFRSs is a net loss of £10.4m (2016: £12.4m loss).

Sensitivity to changes in key assumptions

The table below gives a broad indication of the impact on the pension surplus to changes in assumptions and experience.

All figures are before allowing for deferred tax.

	Approximate impact on current surplus £M	Approximate impact on projected pension cost £M
Reduce discount rate by 0.25%	-5.5	+0.1
Increase inflation assumption by 0.25%	-4.3	+0.1
Change long-term trend of increases in mortality improvement from 1.25% per annum to 1.5% per annum	-1.1	+0.0

Estimated contributions for 2018 financial year

Estimated employer normal contributions in financial year 2018 for the Group and the Society are £2.0m, of which £1.5m is in respect of the deficit from the previous actuarial valuation and £0.5m is in respect of scheme expenses and levies.

Year ended
31 December 2017 **Continued**

27. Related party transactions

Group

Key management personnel comprises the executive directors and non executive directors, who are responsible for ensuring that the Society and its subsidiary undertakings meet their strategic and operational objectives. The Group enters into transactions in the ordinary course of business with directors of the Group and persons connected with the directors of the Group, on normal commercial terms.

Society

Details of the Society's shares in group undertakings and subsidiaries are given in note 13. A number of transactions are entered into with these related parties in the normal course of business. These include loans, deposits, and the payment and recharge of administrative expenses. The volumes of related party transactions, outstanding balances at the year end, and the related income and expenses for the year are as follows:

	Society subsidiaries		Directors and connected persons	
	2017 £M	2016 £M	**2017 £M**	2016 £M
Loans payable to the Society				
Loans outstanding at 1 January	**14.5**	40.4	**0.6**	0.4
Net movement during the year	**41.4**	(25.9)	**0.5**	0.2
Loans outstanding at 31 December	**55.9**	14.5	**1.1**	0.6
Deposits payable by the Society				
Deposits outstanding at 1 January	**875.3**	1,285.1	**1.2**	1.3
Net movement during the year	**(259.1)**	(409.8)	**0.1**	(0.1)
Deposits outstanding at 31 December	**616.2**	875.3	**1.3**	1.2

	2017 £M	2016 £M
Directors' emoluments		
Total remuneration	**3.1**	2.8

Directors' emoluments include those emoluments received by directors from the Society and its associated bodies. Further information on directors' emoluments is included in the Directors' Remuneration Report on pages 68 to 81. No directors are active members of the defined benefit section of the Leeds Building Society Pension Scheme (2016: none). Two directors were active members of the defined contribution section of the Leeds Building Society Pension Scheme during 2017 (2016: three).

Year ended
31 December 2017 **Continued**

28. Tax effects relating to each component of other comprehensive income

2017	Group Before tax amount £M	Group Tax benefit/ (expense) £M	Group Net of tax amount £M	Society Before tax amount £M	Society Tax benefit/ (expense) £M	Society Net of tax amount £M
Available for sale investment securities	**(3.9)**	**1.0**	**(2.9)**	**(3.9)**	**1.0**	**(2.9)**
Revaluation loss on properties revalued	**–**	**–**	**–**	**–**	**–**	**–**
Actuarial gains / (losses) on retirement benefit obligations	**2.0**	**(1.5)**	**0.5**	**2.0**	**(1.5)**	**0.5**
Adjustment to tax in relation to prior periods	**–**	**(0.9)**	**(0.9)**	**–**	**(0.8)**	**(0.8)**
Other comprehensive income	**(1.9)**	**(1.4)**	**(3.3)**	**(1.9)**	**(1.3)**	**(3.2)**

2016	Group Before tax amount £M	Group Tax benefit/ (expense) £M	Group Net of tax amount £M	Society Before tax amount £M	Society Tax benefit/ (expense) £M	Society Net of tax amount £M
Available for sale investment securities	7.8	(1.8)	6.0	7.8	(1.8)	6.0
Revaluation loss on properties revalued	(1.8)	0.5	(1.3)	(1.8)	0.5	(1.3)
Actuarial gains / (losses) on retirement benefit obligations	(9.5)	2.5	(7.0)	(9.5)	2.5	(7.0)
Adjustments to tax in relation to prior periods	–	–	–	–	(1.5)	(1.5)
Other comprehensive income	(3.5)	1.2	(2.3)	(3.5)	(0.3)	(3.8)

29. Liquidity risk

Liquidity risk represents the risk that the Group is unable to meet its financial obligations as they fall due, or can only do so at excessive cost. The Group's business model is to fund long term mortgages through short term retail customer deposits. In practice, although mortgages may have long legal contractual maturities and customer deposits may have short notice periods, customer behaviour tends to shorten mortgage lives and extend retail deposits. This reduces the inherent mismatch of the Group's liquidity position, but does not eliminate the risk and therefore the Group is required to take additional steps to manage and monitor the liquidity gap.

The Group's liquidity policy is to maintain sufficient liquid resources to meet statutory, regulatory and operational requirements. These requirements are designed to allow the Group to cover cash flow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group, and to enable the Group to meet its financial obligations. This is achieved through maintaining a prudent level of high quality purchased liquid assets, through committed wholesale funding facilities (including securitisation arrangements) and through management control of the growth of the business.

The development and implementation of liquidity policy is the responsibility of ALCO. The day-to-day management of liquidity is the responsibility of the Treasury Function with oversight from the independent Risk Function.

A series of liquidity stress tests are performed each month to confirm that the level of liquid resources remains appropriate. ALCO is responsible for setting limits over the level and maturity profile of wholesale funding and for monitoring the composition of the Group Statement of Financial Position.

Liquidity policy is approved by ALCO and agreed with the Board. Limits on potential cash flow mismatches over defined time horizons are the principal method of liquidity control. The size of the Group's holdings of readily realisable liquid assets is primarily driven by such potential outflows and access to contingent funding from the Bank of England.

Pledged assets (encumbrance)
The Group has issued a number of debt instruments which are secured against its assets, specifically the retail mortgage portfolio. These provide long term funding from institutional counterparties, either through cash realised from the sale of securities, or through sale and repurchase agreements.

The Society established Leeds Building Society Covered Bond LLP in 2009 and at 31 December 2017 had £1,707.3m covered bonds in issue (2016: £1,245.4m), including €500m issued in 2017 (2016: €500m issued). In addition, the Group had a further £137.5m (2016: £210.8m) of debt securities in issue through the Albion No. 3 securitisation programme. The debt securities issued through the Albion No.2 programme were repaid during the year (2016: £71.7m).

Year ended
31 December 2017 **Continued**

29. Liquidity risk continued

The table below illustrates the external secured funding balances after redemptions in the mortgage pool:

	2017		2016	
	Assets pledged £M	Secured funding £M	Assets pledged £M	Secured funding £M
Secured against loans and advances to customers – Albion No.2 plc	–	–	95.7	71.7
Secured against loans and advances to customers – Albion No.3 plc	165.2	137.5	220.2	210.8
Secured against loans and advances to customers – LBS Covered Bonds LLP	2,463.1	1,707.3	1,842.4	1,245.4
Total	2,628.3	1,844.8	2,158.3	1,527.9

Pledged assets include those available to Leeds Building Society Covered Bonds LLP and Albion No.3 plc to provide collateral to support external funding transactions. The secured funding balances above show issuance external to the Group, and do not include debt securities retained by the Society. All of the assets pledged are retained in the Society's Statement of Financial Position as it substantially retains control of the loans and the risks and rewards associated with them.

The covered bond programme operates under a Mortgage Sale Agreement in which there is an equitable assignment of the loans from the Society to the LLP. Legal title remains with the Society and full transfer of title is not effected until the occurrence of certain 'perfection' events, such as a failure to pay or breach of obligation on behalf of the Society, or the insolvency of the Society or the LLP.

The securitisation programmes operate under a Mortgage Sale Agreement, where there is an equitable assignment of the loans from the seller to the issuers, Albion No.3 plc and Guildford No.1 plc. Legal title remains with the Society and full transfer of title is not effected until the occurrence of certain 'perfection' events such as it being directed by a regulatory authority, the courts or the Society.

Contractual maturity

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables below have been drawn up based on the undiscounted contractual maturities of the financial liabilities including interest that will be accrued to those instruments, except where the Group is entitled and intends to repay the liabilities before their maturity. The subscribed capital has a fixed rate of interest of $13^3/_8$% payable semi-annually for an indeterminate period.

31 December 2017	Repayable on demand £M	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Group & Society						
Shares	5,984.6	840.9	3,187.6	3,134.9	72.8	13,220.8
Amounts owed to credit institutions	–	951.0	–	–	–	951.0
Other deposits	–	190.7	64.3	1.4	–	256.4
Debt securities in issue	–	313.7	320.0	1,738.7	459.8	2,832.2
Subscribed capital	–	–	–	–	25.0	25.0
Total liabilities	5,984.6	2,296.3	3,571.9	4,875.0	557.6	17,285.4

31 December 2016	Repayable on demand £M	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Group & Society						
Shares	5,578.7	531.6	1,912.2	3,124.5	54.8	11,201.8
Amounts owed to credit institutions	–	572.1	–	–	–	572.1
Other deposits	–	265.7	89.8	21.5	–	377.0
Debt securities in issue	–	10.0	77.3	1,956.8	427.1	2,471.2
Subscribed capital	–	–	–	–	25.0	25.0
Total liabilities	5,578.7	1,379.4	2,079.3	5,102.8	506.9	14,647.1

29. Liquidity risk continued

The following table details the Group's expected maturity for its derivative financial instruments. The table has been drawn up based on the undiscounted net cash inflows / (outflows) on the derivative instruments that settle on a net basis and the undiscounted gross inflows / (outflows) on those derivatives that require gross settlement. When the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to the conditions existing at the reporting date. For example, interest rates have been projected as illustrated by the yield curves existing at the reporting date, and where the amount varies with changes in an index, the amount disclosed may be based on the level of the index at the reporting date.

31 December 2017	**Less than 3 months £M**	**3 to 12 months £M**	**1 to 5 years £M**	**Over 5 years £M**	**Total £M**
Swap contracts	**27.3**	**47.6**	**124.5**	**140.8**	**340.2**

31 December 2016	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Swap contracts	15.2	41.3	93.0	79.3	228.8

Maturity profile of financial instruments

The table below analyses the Group's financial assets and liabilities into relevant maturity groupings, based on the remaining period between the date of the Statement of Financial Position and the contractual maturity date.

31 December 2017 Group	**Repayable on demand £M**	**Less than 3 months £M**	**3 to 12 months £M**	**1 to 5 years £M**	**Over 5 years £M**	**Total £M**
Financial assets						
Cash in hand and balances with the Bank of England	**1,757.6**	**–**	**–**	**–**	**–**	**1,757.6**
Loans and advances to credit institutions	**–**	**194.0**				**194.0**
Derivative financial instruments	**–**	**1.2**	**10.4**	**217.7**	**29.2**	**258.5**
Loans and advances to customers						
Loans fully secured on residential property	**10.5**	**7.4**	**32.2**	**422.5**	**14,435.8**	**14,908.4**
Other loans	**11.5**	**–**	**5.2**	**27.0**	**258.4**	**302.1**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**3.0**	**6.5**	**3.0**	**12.5**
Investment securities	**–**	**20.9**	**115.3**	**490.6**	**151.9**	**778.7**
Total financial assets	**1,779.6**	**223.5**	**166.1**	**1,164.3**	**14,878.3**	**18,211.8**
Financial liabilities						
Shares	**69.5**	**5,751.3**	**3,951.5**	**3,216.1**	**83.1**	**13,071.5**
Fair value adjustment for hedged risk on shares	**–**	**(0.5)**	**(3.0)**	**(2.2)**	**(0.1)**	**(5.8)**
Derivative financial instruments	**–**	**9.5**	**12.6**	**35.0**	**104.8**	**161.9**
Amounts owed to credit institutions, other customers and debt securities in issue	**99.0**	**504.2**	**376.3**	**2,641.5**	**440.6**	**4,061.6**
Subscribed capital	**–**	**–**	**–**	**–**	**25.0**	**25.0**
Total financial liabilities	**168.5**	**6,264.5**	**4,337.4**	**5,890.4**	**653.4**	**17,314.2**

29. Liquidity risk continued

31 December 2016 Group	Repayable on demand £M	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Financial assets						
Cash in hand and balances with the Bank of England	938.9	–	–	–	–	938.9
Loans and advances to credit institutions		187.3				187.3
Derivative financial instruments	–	1.6	11.7	137.4	112.4	263.1
Loans and advances to customers						
Loans fully secured on residential property	14.0	6.3	31.6	369.6	12,634.6	13,056.1
Other loans	18.8	42.9	56.6	30.1	203.1	351.5
Fair value adjustment for hedged risk on loans and advances to customers	–	–	19.8	43.9	6.4	70.1
Investment securities	–	59.5	72.2	493.9	152.2	777.8
Total financial assets	971.7	297.6	191.9	1,074.9	13,108.7	15,644.8
Financial liabilities						
Shares	116.3	5,206.8	2,418.7	3,405.8	54.5	11,202.1
Fair value adjustment for hedged risk on shares	–	2.0	12.2	16.6	0.3	31.1
Derivative financial instruments	–	0.6	8.8	99.2	105.8	214.4
Amounts owed to credit institutions, other customers and debt securities in issue	79.0	212.3	155.4	2,510.5	443.6	3,400.8
Subscribed capital	–	–	–	–	25.0	25.0
Total financial liabilities	195.3	5,421.7	2,595.1	6,032.1	629.2	14,873.4

31 December 2017 Society	**Repayable on demand £M**	**Less than 3 months £M**	**3 to 12 months £M**	**1 to 5 years £M**	**Over 5 years £M**	**Total £M**
Financial assets						
Cash in hand and balances with the Bank of England	**1,757.6**	**–**	**–**	**–**	**–**	**1,757.6**
Loans and advances to credit institutions	**–**	**80.9**	**–**	**–**	**–**	**80.9**
Derivative financial instruments	**–**	**1.2**	**6.6**	**156.4**	**3.3**	**167.5**
Loans and advances to customers						
Loans fully secured on residential property	**10.5**	**7.4**	**32.2**	**422.5**	**14,435.8**	**14,908.4**
Other loans	**11.5**	**–**	**5.2**	**27.0**	**258.4**	**302.1**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**3.0**	**6.5**	**3.0**	**12.5**
Investment securities	**–**	**20.9**	**115.3**	**490.6**	**679.4**	**1,306.2**
Total financial assets	**1,779.6**	**110.4**	**162.3**	**1,103.0**	**15,379.9**	**18,535.2**
Financial liabilities						
Shares	**69.5**	**5,751.3**	**3,951.5**	**3,216.1**	**83.1**	**13,071.5**
Fair value adjustment for hedged risk on shares	**–**	**(0.5)**	**(3.0)**	**(2.2)**	**(0.1)**	**(5.8)**
Derivative financial instruments	**–**	**9.5**	**12.6**	**34.7**	**96.9**	**153.7**
Amounts owed to credit institutions, other customers and debt securities in issue	**71.2**	**505.5**	**422.5**	**3,080.7**	**445.0**	**4,524.9**
Subscribed capital	**–**	**–**	**–**	**–**	**25.0**	**25.0**
Total financial liabilities	**140.7**	**6,265.8**	**4,383.6**	**6,329.3**	**649.9**	**17,769.3**

29. Liquidity risk continued

31 December 2016 Society	Repayable on demand £M	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M	Total £M
Financial assets						
Cash in hand and balances with the Bank of England	938.9	–	–	–	–	938.9
Loans and advances to credit institutions	–	66.3	–	–	–	66.3
Derivative financial instruments	–	1.6	11.7	75.2	85.8	174.3
Loans and advances to customers						
Loans fully secured on residential property	14.0	6.3	31.6	369.6	12,634.6	13,056.1
Other loans	18.8	42.9	56.6	30.1	203.1	351.5
Fair value adjustment for hedged risk on loans and advances to customers	–	–	10.1	53.4	6.6	70.1
Investment securities	–	59.5	108.1	539.3	739.8	1,446.7
Total financial assets	971.7	176.6	218.1	1,067.6	13,669.9	16,103.9
Financial liabilities						
Shares	116.3	5,206.8	2,418.7	3,405.8	54.5	11,202.1
Fair value adjustment for hedged risk on shares	–	2.0	12.2	16.6	0.3	31.1
Derivative financial instruments	–	0.6	8.8	96.7	107.0	213.1
Amounts owed to credit institutions, other customers and debt securities in issue	115.6	210.3	94.7	3,098.7	443.6	3,962.9
Subscribed capital	–	–	–	–	25.0	25.0
Total financial liabilities	231.9	5,419.7	2,534.4	6,617.8	630.4	15,434.2

Year ended
31 December 2017 **Continued**

30. Interest rate risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes adversely as a consequence of movements in market variables.

The primary market risk faced by the Group is interest rate risk. The net interest income and asset position of the Group is exposed to movements in interest rates. This exposure is managed on a continuous basis, within limits set by the Board, using a combination of offsetting assets and liabilities and derivatives. The Group uses interest rate stress testing and gap analysis to monitor and manage its interest rate position.

The Group does not run a trading book and therefore does not have the type of higher risk exposure run by many banking institutions. Given the Group's policy of hedging fixed rate assets and liabilities back to floating rate, outright interest rate risk arises mainly from the Board's decision to invest the Group's reserves according to a specified fixed rate maturity profile.

The following table provides a summary of the interest rate re-pricing profile of the Group's assets and liabilities as at 31 December 2017. Assets and liabilities have been allocated to time bands by reference to the earlier of the next interest rate reset date and the contractual maturity date. The table takes account of derivative financial instruments whose effect is to alter the interest basis of Group assets and liabilities. The non-interest bearing balances have been included in a separate column.

31 December 2017	Less than 3 months £M	3 to 6 months £M	6 to 12 months £M	1 to 5 years £M	More than 5 years £M	No specific reprice date £M	Non-interest bearing £M	Total £M
Assets								
Liquid assets	2,263.3	23.9	80.4	338.9	6.1	–	17.7	2,730.3
Loans and advances to customers	4,038.8	1,002.3	2,250.0	7,474.0	318.7	–	126.7	15,210.5
Total interest bearing assets	6,302.1	1,026.2	2,330.4	7,812.9	324.8	–	144.4	17,940.8
Total non-interest bearing assets	–	–	–	–	–	–	543.2	543.2
Total assets	6,302.1	1,026.2	2,330.4	7,812.9	324.8	–	687.6	18,484.0

	Less than 3 months £M	3 to 6 months £M	6 to 12 months £M	1 to 5 years £M	More than 5 years £M	No specific reprice date £M	Non-interest bearing £M	Total £M
Liabilities								
Shares	5,751.3	1,249.1	2,702.4	3,216.1	83.1	–	69.5	13,071.5
Amounts owed to credit institutions, other customers and debt securities in issue	1,608.2	92.0	280.0	1,585.3	444.1	–	52.0	4,061.6
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Total interest bearing liabilities	7,359.5	1,341.1	2,982.4	4,801.4	527.2	25.0	121.5	17,158.1
Total non-interest bearing liabilities and equity	–	–	–	–	–	–	1,325.9	1,325.9
Total liabilities and equity	7,359.5	1,341.1	2,982.4	4,801.4	527.2	25.0	1,447.4	18,484.0
Effect of derivatives	2,355.2	401.4	408.5	(2,910.6)	(254.5)	–	–	–
Interest rate sensitivity gap	1,297.8	86.5	(243.5)	100.9	(456.9)	(25.0)	(759.8)	–

30. Interest rate risk continued

31 December 2016	Less than 3 months £M	3 to 6 months £M	6 to 12 months £M	1 to 5 years £M	More than 5 years £M	No specific reprice date £M	Non-interest bearing £M	Total £M
Assets								
Liquid assets	1,397.5	–	67.5	394.3	26.6	–	18.1	1,904.0
Loans and advances to customers	4,520.6	477.0	1,444.5	6,634.0	229.0	–	102.5	13,407.6
Total interest bearing assets	5,918.1	477.0	1,512.0	7,028.3	255.6	–	120.6	15,311.6
Total non-interest bearing assets	–	–	–	–	–	–	618.1	618.1
Total assets	5,918.1	477.0	1,512.0	7,028.3	255.6	–	738.7	15,929.7

	Less than 3 months £M	3 to 6 months £M	6 to 12 months £M	1 to 5 years £M	More than 5 years £M	No specific reprice date £M	Non-interest bearing £M	Total £M
Liabilities								
Shares	5,206.8	1,160.9	1,257.8	3,405.8	54.5	–	116.3	11,202.1
Amounts owed to credit institutions, other customers and debt securities in issue	1,439.1	78.0	16.5	1,353.3	426.1	–	87.8	3,400.8
Subscribed capital	–	–	–	–	–	25.0	–	25.0
Total interest bearing liabilities	6,645.9	1,238.9	1,274.3	4,759.1	480.6	25.0	204.1	14,627.9
Total non-interest bearing liabilities and equity	–	–	–	–	–	–	1,301.8	1,301.8
Total liabilities and equity	6,645.9	1,238.9	1,274.3	4,759.1	480.6	25.0	1,505.9	15,929.7
Effect of derivatives	2,346.4	643.7	(327.8)	(2,700.2)	37.9	–	–	–
Interest rate sensitivity gap	1,618.6	(118.2)	(90.1)	(431.0)	(187.1)	(25.0)	(767.2)	–

Liquid assets comprise cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities.
The Group uses derivatives to manage interest rate risk and reduce the Group's overall interest rate gap position. The profile of the interest flows arising from these derivatives is set out above.
The Society's interest rate repricing profile is not materially different to the Group position.
The Group monitors the impact of a range of possible interest rate changes on its assets and liabilities closely and sensitivities are reported to ALCO on a monthly basis. The following table details the Group's and Society's sensitivity to a 200 basis point change in interest rates at the year end (with all other variables held constant). A positive number indicates an increase in profit or other equity.

	Group and Society +200bps 2017 £M	Group and Society +200bps 2016 £M	**Group and Society -200bps 2017 £M**	Group and Society -200bps 2016 £M
Impact	**(9.9)**	(1.2)	**6.4**	0.6

Interest rate risk is managed on a Group basis. The Society will differ to the overall Group position as the sensitivity would generate offsetting movements in the subsidiaries.

The above interest rate risk represents the market value movement, calculated using a discounted cashflow basis, on all of the Group's financial assets and liabilities, resulting from an immediate 200 basis points parallel shift in interest rates. All exposures include investments of the Group's reserves. Other interest rate risk exposures, such as basis risk (the risk of loss arising from changes in the relationship between interest rates which have similar but not identical characteristics – such as LIBOR and Bank of England base rate) and prepayment risk (the risk of loss arising from early repayments of fixed rate mortgages and loans) are also monitored closely and regularly reported to ALCO.

31. Currency risk

Foreign currency risk arises as a result of the Group's activities in raising funds and making investments in foreign currencies. This is done to ensure cost effective funding is obtained across a wider pool of providers. The Group's policy is not to run any speculative foreign exchange positions. The majority of the Group's assets and liabilities are denominated in sterling; however it also holds Euro mortgages and receives funding via retail deposits and its debt issuance in foreign currencies, which give rise to exchange rate impacts. Cross currency interest rate swaps and basis swaps are utilised to reduce both the interest rate and exchange rate risk exposures that arise from operating in foreign currencies.

The carrying amount of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date is as follows:

	Assets		Liabilities	
Group & Society	**2017 £M**	2016 £M	**2017 £M**	2016 £M
Euro	**1,941.7**	3,060.6	**1,945.9**	3,056.9

At the year end the Group has hedges in place to match 100% of its foreign currency exposures, via the use of currency swaps which offset the impact of foreign exchange fluctuations. Therefore any movement in foreign currency through profit or loss and other equity will be minimised.

The reduction in both assets and liabilities between 2016 and 2017 is due to a change in calculation methodology to more accurately reflect the economic risk exposure of the Group. On a like-for-like basis, the figures for 2016 would have been assets of £1,444.7m and liabilities of £1,441.0m.

32. Wholesale credit risk

The Group holds various investments in order to satisfy operational demand and to meet current and future liquidity regulatory requirements. Credit risk arises because of the risk of factors such as deterioration in the individual investee's financial health and uncertainty within the wholesale market generally. Wholesale lending credit risk is managed through setting strict upper and lower limits to each type of investment that are dependent on criteria such as: time to maturity, credit rating and originating country. These limits are set by ALCO and monitored by the Treasury Function on a continuous basis.

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

At 31 December 2017 none of the Group's wholesale portfolio exposure was either past due or impaired (2016: none). There are no assets that would otherwise be past due or impaired whose terms have been renegotiated. 99.7% (2016: 99.8%) of the Group's wholesale investments are rated single A or better. The Group has implemented a policy that initial investments in wholesale assets must be grade A3 or above.

Counterparty credit ratings are used to inform the Group's assessment of wholesale credit risk. The table below provides ratings details for the Group's wholesale investment portfolio as at 31 December 2017:

	Group & Society	
	2017 %	2016 %
Aaa	**20.3**	21.0
Aa1-Aa3	**67.6**	54.2
A1-A3	**3.9**	8.9
Sovereign exposure to the UK	**7.9**	15.7
Other	**0.3**	0.2
Total	**100.0**	100.0

32. Wholesale credit risk continued

All wholesale exposures are to financial institutions in major industrial countries. The largest exposure to a single institution other than the UK Government was £88.8m (2016: £84.2m).

In addition, the Group's exposure to counterparty concentrations is also kept under watch. Limits exist to mitigate the risk of overexposure to geographical areas, and these are continuously reviewed and updated. At 31 December 2017, the Group had exposures to the following geographical regions:

Group	2017 £M	2017 %	2016 £M	2016 %
UK	**2,535.7**	**92.8**	1,658.9	87.2
Europe split into individual countries as follows:				
Germany	**53.9**	**2.0**	33.2	1.7
Ireland	**0.6**	**–**	0.6	–
Netherlands	**–**	**–**	34.9	1.8
European Supranational	**57.3**	**2.1**	65.8	3.5
North America	**7.5**	**0.3**	17.7	0.9
Global Supranational	**54.2**	**2.0**	64.6	3.4
Far East	**21.1**	**0.8**	28.3	1.5
Total wholesale exposures	**2,730.3**	**100.0**	1,904.0	100.0

The Society's geographical exposure is equal to the Group's except it holds £3,017.7m (2016: £2,246.2m) in the UK.

The nature of the instrument determines the level of collateral held. Loans and debt securities are generally unsecured with the exception of asset-backed securities which are secured by a collection of financial assets. The Group prefers to document its derivative activity via the International Swaps and Derivatives Association (ISDA) Master Agreement. The majority of the Group's derivatives are transacted through a central clearing house. In conjunction with this the Group has executed with some counterparties a Credit Support Annex (CSA). Under a CSA, cash is posted as collateral between the counterparties of the deal to mitigate some of the counterparty credit risk inherent in outstanding derivative positions, as well as credit risk exposure arising on sale and repurchase transactions and guaranteed equity bonds.

Transactions are usually settled on a gross basis, and therefore there is no netting in the Financial Statements. Legally the Group does have a right of set-off for those transactions. Accordingly the credit risk associated with such contracts is reduced to the extent that negative mark to market valuations on derivatives will offset positive mark to market values on derivatives, subject to an absolute of zero.

Wholesale credit risk is recorded in the below extracts from the Statement of Financial Position:

	Group		Society	
	2017 £M	2016 £M	2017 £M	2016 £M
Cash in hand and balances with the Bank of England	**1,757.6**	938.9	**1,757.6**	938.9
Loans and advances to credit institutions	**194.0**	187.3	**80.9**	66.3
Investment securities	**778.7**	777.8	**1,306.2**	1,446.7
Wholesale exposures	**2,730.3**	1,904.0	**3,144.7**	2,451.9
Derivative financial instruments	**258.5**	263.1	**167.5**	174.3
Total wholesale credit risk	**2,988.8**	2,167.1	**3,312.2**	2,626.2
Investment securities, which are shown after fair value and impairment adjustments, can be further analysed as:				
UK Government securities	**215.7**	298.6	**215.7**	298.6
Supranational bonds	**186.5**	244.6	**186.5**	244.6
Covered bonds	**219.0**	96.9	**219.0**	96.9
Permanent interest bearing shares	**1.7**	1.7	**1.7**	1.7
Residential mortgage backed securities	**155.8**	136.0	**683.3**	804.9
Total investment securities	**778.7**	777.8	**1,306.2**	1,446.7

33. Credit risk on loans and advances to customers

Credit risk management

A dedicated Credit Risk Function oversees and supports the management of credit risk within the Group such that controls continue to be effective in maintaining an appropriate credit risk profile of business within a predefined Board appetite. In delivering this, variations in drivers of credit risk emanating from market, economic or competitive changes are identified and understood with any necessary changes made to re-align the credit risk profile to desired levels within Board appetite.

Comprehensive management insight and information enable the prevailing, future and stressed levels of credit risk within the Group's credit portfolios to be understood and any adverse trends to be identified before impacting on performance.

The Group has managed all types of credit risk in a consistent manner as in previous years.

The Group's exposure to retail credit risk can be broken down as below:

	Group & Society	
	2017 £M	2016 £M
Retail mortgages	**14,932.0**	13,081.9
Commercial lending	**71.6**	125.3
Other loans	**185.3**	184.9
Total gross exposure (contractual amounts)	**15,188.9**	13,392.1
Impairment and fair value adjustments	**21.6**	15.5
Total net exposure	**15,210.5**	13,407.6

Other loans include a collateral loan secured on equity release mortgages of £182.8 m (2016:£182.4 m) and other loans of £2.5 m (2016:£2.5 m).

Retail mortgages

The Group is firmly committed to the management of credit risk at all stages of the lending cycle. The Group closely monitors customer affordability and income multiples at the application stage. It employs appropriate underwriting and fraud detection techniques to minimise losses once loans have been approved, and it also takes a proactive approach to the control of bad and doubtful debt which is managed by a specialist team dedicated solely to the collections and recovery process.

The Group monitors individual borrowers but also sets and applies limits to manage concentration risk. The limits are managed through the mortgage application process and monitored throughout the life of the products to ensure that new lending complements the risk profile of loans already within the Group's portfolio. This mitigates the risk that the Group is overexposed to borrowers with similar characteristics, for example properties in similar locations where local housing market fluctuations may arise.

The geographical concentration of residential mortgage loans is as follows:

	Group & Society	
	2017 %	2016 %
Scotland	**7.3**	6.8
North East	**3.9**	4.0
Yorkshire and Humberside	**9.9**	10.5
North West	**8.1**	8.2
Midlands	**14.9**	14.7
East of England	**4.9**	4.8
South West	**8.4**	8.3
Greater London	**16.4**	16.1
South East	**18.8**	18.8
Wales	**3.0**	3.1
Northern Ireland	**2.5**	2.7
Republic of Ireland	**1.1**	1.2
Spain	**0.6**	0.6
Other	**0.2**	0.2
Total	**100.0**	100.0

The Group's retail lending exposures are predominantly in the UK, with some exposure in the Republic of Ireland and Spain. The risk characteristics of the Irish residential portfolio are different from the rest of the Group's residential portfolio because of higher average arrears rates and higher falls in property prices since origination on the Irish portfolio. The majority of borrowers in the Spanish residential portfolio are UK residents.

33. Credit risk on loans and advances to customers continued

Loan to value distribution of retail mortgage balance

One of the key indicators of the credit risk associated with a mortgage book is the relationship between the amount of the loan made and the value of the underlying security, which is known as the loan to value percentage. In general the lower the loan to value percentage the greater the equity within the property, and the lower the losses expected to be realised in the event of default and subsequent repossession.

The Group sets strict loan to value criteria for new loans, which must be supported by an external expert valuation of the security. The loan to value profile of the Group's book is monitored closely against the limits set by the Credit Committee.

The indexed loan to value analysis on the Group's residential loan portfolio is as follows:

	Group & Society	
	2017 %	2016 %
<70%	**76.8**	73.7
70% – 80%	**12.9**	16.0
80% – 90%	**7.5**	7.5
>90%	**2.8**	2.8
Total	**100.0**	100.0

The overall weighted average loan to value of the residential portfolio is 56% (2016: 57%). The overall indexed loan to value on the collateral loan is 32% (2016: 32%). The collateral held against this loan is an equity release mortgage portfolio secured on property with a value of £577m (2016: £584m). The weighted average loan to value of new lending in 2017 was 63.9% (2016: 65.2%).

The table below provides further information on the Group's loans and advances to customers by payment due status as at 31 December 2017, excluding fair value gains and impairment losses. The table includes £37.5m (2016: £40.3m) of loans and advances secured on residential property in the Republic of Ireland that are past due and £1.2m (2016: £0.4m) in possession. Of the loans and advances secured on residential property in Spain £11.2m (2016: £11.8m) are past due and £0.6m (2016: £0.8m) are in possession.

	Group & Society Residential		Group & Society Other	
	2017 £M	**2017 %**	**2017 £M**	**2017 %**
Not impaired:				
– Neither past due nor impaired	**14,613.0**	**97.8**	**182.8**	**98.7**
– Past due up to 3 months but not impaired	**221.6**	**1.4**	**–**	**–**
Impaired:				
– Not past due but impaired	**–**	**–**	**2.5**	**1.3**
– Past due 3 to 6 months	**38.6**	**0.3**	**–**	**–**
– Past due 6 to 12 months	**22.5**	**0.2**	**–**	**–**
– Past due over 12 months	**28.1**	**0.2**	**–**	**–**
– Possessions	**8.2**	**0.1**	**–**	**–**
Total gross exposure	**14,932.0**	**100.0**	**185.3**	**100.0**

	Group & Society Residential		Group & Society Other	
	2016 £M	2016 %	2016 £M	2016 %
Not impaired:				
– Neither past due nor impaired	12,718.7	97.3	182.4	98.6
– Past due up to 3 months but not impaired	240.4	1.8	–	–
Impaired				
– Not past due but impaired	–	–	2.5	1.4
– Past due 3 to 6 months	50.9	0.4	–	–
– Past due 6 to 12 months	31.8	0.2	–	–
– Past due over 12 months	30.6	0.2	–	–
– Possessions	9.5	0.1	–	–
Total gross exposure	13,081.9	100.0	184.9	100.0

33. Credit risk on loans and advances to customers continued

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

Fair value of collateral held for residential mortgages

The collateral held against residential mortgages consists of residential houses. The use of such collateral is in line with terms that are usual and customary in standard lending activities.

Upon initial recognition of loans and advances, the fair value of collateral is based on the purchase price of the property. In subsequent periods, the fair value is updated to reflect current market price based on the quarterly Halifax regional house price index.

The table below shows the collateral held capped at 100% of the individual loan amount:

	Group & Society	
	2017 £M	2016 £M
Neither past due nor impaired	**14,565.7**	12,671.2
Past due but not impaired	**217.9**	237.0
Past due and impaired	**89.0**	110.4
Possessions	**7.6**	8.4
Total collateral	**14,880.2**	13,027.0

Forbearance strategies

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

The table below provides further information on loans existing at the 2017 reporting date by types of account renegotiations applied to borrowers over the last 12 months. This includes all renegotiations regardless of whether or not our customer has experienced financial difficulty in repaying their loan with the Group. For clarity, this table includes all balances which have had their terms renegotiated in the last 12 months, regardless of whether the renegotiation is still in place or whether the loan has reverted to its original terms.

Group and Society 2017	**Payment arrangement £M**	**Concessions £M**	**Capitalisations £M**	**Transfer to interest only £M**	**Term extensions £M**	**Other £M**	**Total forbearance £M**
Neither past due nor impaired	**13.1**	**1.6**	**4.0**	**28.6**	**71.2**	**1.7**	**120.2**
Past due up to 3 months	**32.9**	**5.1**	**1.0**	**0.4**	**1.1**	**0.3**	**40.8**
Past due more than 3 months	**23.4**	**1.0**	**–**	**–**	**–**	**–**	**24.4**
Possessions	**0.2**	**–**	**–**	**0.1**	**–**	**–**	**0.3**
Total forbearance	**69.6**	**7.7**	**5.0**	**29.1**	**72.3**	**2.0**	**185.7**

Group and Society 2016	Payment arrangement £M	Concessions £M	Capitalisations £M	Transfer to interest only £M	Term extensions £M	Other £M	Total forbearance £M
Neither past due nor impaired	18.2	3.9	2.6	19.4	58.8	3.9	106.8
Past due up to 3 months	45.2	6.5	0.5	0.6	1.0	0.4	54.2
Past due more than 3 months	33.2	2.9	–	–	–	0.1	36.2
Possessions	1.1	0.1	–	0.1	–	–	1.3
Total forbearance	97.7	13.4	3.1	20.1	59.8	4.4	198.5

33. Credit risk on loans and advances to customers continued

Commercial mortgages

Credit risk associated with lending to businesses is affected by similar factors to those affecting retail mortgages, although on average loans are generally larger than to individual customers. The Group ceased new commercial lending in 2008. All commercial lending is based in the UK.

The Group monitors the profile of the commercial portfolio in much the same way as for retail mortgages, with regular review of concentration limits. As the credit risk associated with commercial loans is more closely linked to the performance of a specific industry, in addition to the loan to value, concentration risk by industry is also assessed:

Industry type	Group & Society	
	2017 %	2016 %
Leisure and hotel	**4.0**	2.4
Retail	**29.5**	22.0
Offices	**34.4**	53.1
Commercial investment and industrial units	**28.7**	20.3
Others, including mixed use	**3.4**	2.2
Total	**100.0**	100.0

Loan to value

The indexed loan to value analysis on the Group's commercial loan portfolio is as follows:

	Group & Society	
	2017 %	2016 %
<70%	**29.5**	30.4
70% – 80%	**13.3**	29.9
80% – 90%	**5.4**	4.5
>90%	**51.8**	35.2
Total percentage	**100.0**	100.0

The overall indexed loan to value of the commercial portfolio is 85% (2016: 76%).

The table below provides further information on the Group's commercial loans and advances by payment due status as at 31 December 2017, excluding impairment losses.

	Group & Society		Group & Society	
	2017 £M	**2017 %**	2016 £M	2016 %
Not impaired:				
– Neither past due nor impaired	**32.8**	**45.7**	75.0	59.9
Impaired:				
– Not past due but impaired	**34.8**	**48.6**	43.0	34.3
– Past due up to 3 months	**–**	**–**	0.1	0.1
– Possessions	**4.0**	**5.7**	7.2	5.7
Total gross exposure	**71.6**	**100.0**	125.3	100.0

Loans in the analysis above which are less than three months past due have collective impairment allowances set aside to cover credit losses on loans which are in the early stages of arrears, or for which a loss event has occurred. No loans (2016: none) that would be past due or impaired have had their terms renegotiated during 2017.

33. Credit risk on loans and advances to customers continued

Fair value of collateral held for commercial loans

The collateral held against commercial loans consists of commercial property. The use of such collateral is in line with terms that are usual and customary to commercial lending activities. The fair value is based on open market value or indices of similar assets. The loans and the associated collateral are monitored individually by a specialist team. The level of collateral at 31 December 2017 reflects the reduction in the portfolio size during the year.

	Group & Society	
	2017 £M	2016 £M
Neither past due nor impaired	**29.8**	72.0
Impaired	**26.5**	35.2
Possession	**3.4**	4.4
Total collateral	**59.7**	111.6

The table above shows the collateral held capped at 100% of the individual loan amount.

34. Derivative financial instruments

Derivative financial instruments are contracts or arrangements whose value is derived from one or more underlying price, rate or index inherent in the contract or arrangement, such as interest rates, exchange rates or stock market indices. These types of instruments tend to have a smaller or no initial net investment relative to financial assets / liabilities offering the same risk / return as cash flows and are generally settled at a future date. Derivatives are only used by the Group in accordance with Section 9A of the Building Societies Act 1986, to reduce the risk of loss arising from changes in interest rates or other factors of a prescribed description which affect the business. Accordingly, such instruments are not used in trading activity or for speculative purposes. The Group utilises its derivative instruments for hedging purposes.

Types of derivatives

The main derivatives used by the Group are interest rate swaps, interest rate options, and cross currency swaps. The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the types of derivatives which are typically used in managing such risks. These risks may alternatively be managed using on Statement of Financial Position instruments or natural hedges that exist in the Group Statement of Financial Position.

Activity	Risk	Type of Derivative
Fixed rate savings products	Sensitivity to changes in interest rates	Receive fixed interest rate swaps (fair value hedge)
Fixed rate mortgage lending	Sensitivity to changes in interest rates	Pay fixed interest rate swaps (fair value hedge)
Fixed rate wholesale funding	Sensitivity to changes in interest rates	Receive fixed interest rate swaps (fair value hedge)
Fixed rate asset investments	Sensitivity to changes in interest rates	Pay fixed interest rate swaps (fair value hedge)
Equity linked savings products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Equity release mortgages	Sensitivity to changes in interest rates	Pay fixed interest rate swaps
Investment and funding in foreign currency	Sensitivity to changes in foreign exchange rates	Cross currency interest rate swaps and foreign exchange contracts (fair value hedge)
Issuance of debt securities on different interest bases	Sensitivity to divergence between interest rate bases	Pay floating receive floating interest rate swaps

The Group manages risk within its risk tolerance, regardless of the accounting treatment.

Derivatives for use in hedge relationships are entered into only when the underlying position being hedged contains the same risk features. The derivative used will match the risks of the underlying asset or liability and therefore hedge the associated market risk. Certain financial instruments (including retail products) contain features that are similar to derivatives and in these cases risk is managed by entering derivative contracts that have matching features.

34. Derivative financial instruments continued

All derivatives entered in to by the Group are used for hedging purposes, however not all are designated as such for accounting purposes. Some derivatives are held as economic hedges to which hedge accounting does not need to be applied. In these cases a natural offset may be achieved; these types of hedge are only entered in to where a high degree of effectiveness can be achieved.

The Group utilises fair value accounting hedges. Fair value hedges are designated to manage the interest rate risk associated with fixed rate products (typically mortgages and savings). All hedges are supported by comprehensive hedging documentation, as per the requirement in IAS 39.

Cross currency interest rate swaps are used to reduce both the interest rate risk and exchange rate risk exposures that come from funding in foreign currency.

The Group discounts its collateralised and un-collateralised positions based on overnight interest rate curves.

	Group 2017			Group 2016		
	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M
Interest rate swaps designated as fair value hedges	15,048.0	76.9	(45.5)	14,929.2	114.1	(99.9)
Derivatives not designated as accounting hedges:						
Equity swaps	109.3	4.7	(64.9)	173.3	14.1	(69.8)
Interest rate swaps	300.5	0.7	(0.8)	573.8	2.8	(0.1)
Cross currency swaps	1,968.5	173.0	(47.4)	1,544.5	131.6	(40.7)
Floating swaps	1,589.0	2.3	(1.1)	1,148.5	0.5	(1.5)
Bank base rate swaps	905.5	0.9	(2.2)	149.2	–	(2.4)
Total derivatives held for hedging	19,920.8	258.5	(161.9)	18,518.5	263.1	(214.4)

	Society 2017			Society 2016		
	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M	Contract or underlying principal amount £M	Positive market value £M	Negative market value £M
Interest rate swaps designated as fair value hedges	13,659.6	55.8	(40.9)	14,003.0	81.3	(98.7)
Derivatives not designated as accounting hedges:						
Equity swaps	109.3	4.7	(64.9)	173.3	14.1	(69.8)
Interest rate swaps	154.7	0.7	–	289.1	1.3	–
Cross currency swaps	941.6	103.1	(44.6)	945.8	77.1	(40.7)
Floating swaps	1,589.0	2.3	(1.1)	1,148.5	0.5	(1.5)
Bank base rate swaps	905.5	0.9	(2.2)	149.2	–	(2.4)
Total derivatives held for hedging	17,359.7	167.5	(153.7)	16,708.9	174.3	(213.1)

34. Derivative financial instruments continued

Market risk

Market risk is the risk that the value of, or income arising from, the Group's assets and liabilities changes adversely due to movements in interest rates (including interest bases) or foreign currency rates. These risks are measured and managed at Group level.

The Group recognises that the effective management of market risk is essential to the maintenance of stable earnings and the preservation of member value.

The Group's exposure to market risk is governed by a policy approved by ALCO. This policy sets out the nature of risk which may be taken and aggregate risk limits. Based on these aggregate limits, ALCO assigns risk limits to all Group businesses and monitors compliance with these limits. At each meeting ALCO reviews reports showing the Group's exposure to market and liquidity risks.

The Group's exposure to market risk is managed by the Treasury Function by using appropriate hedging instruments or by taking advantage of natural hedges within the Group. Market risk is managed within a clearly defined framework of policy limits.

Market risk is measured and reported using a variety of techniques, according to the appropriateness of the technique to the exposure concerned. The techniques used include interest rate gap analysis, duration analysis, basis point value analysis, scenario analysis, and earnings at risk.

There has been no change in the year to the Group's approach to managing and measuring market risk.

Other price risk

Other price risk is the risk resulting from the possibility that the price of a security may decline.

The Group's policy is to have no material exposure to equity markets and to purchase only high quality liquid assets. Any exposures arising from the Group's products are eliminated as far as it is practicable by appropriate hedging contracts.

The following tables analyse the derivatives by contractual and residual maturity:

	Group 2017		Group 2016	
	Notional principal amount £M	**Replacement cost £M**	Notional principal amount £M	Replacement cost £M
Interest rate swaps	**17,952.3**	**85.5**	16,974.0	131.5
Cross currency swaps	**1,968.5**	**173.0**	1,544.5	131.6
Total derivatives	**19,920.8**	**258.5**	18,518.5	263.1
Under 1 year	**4,688.9**	**12.6**	4,573.1	13.3
Between 1 and 5 years inclusive	**12,228.1**	**213.0**	12,003.2	137.6
Over 5 years	**3,003.8**	**32.9**	1,942.2	112.2
Total derivatives	**19,920.8**	**258.5**	18,518.5	263.1

	Society 2017		Society 2016	
	Notional principal amount £M	**Replacement cost £M**	Notional principal amount £M	Replacement cost £M
Interest rate swaps	**16,418.1**	**64.4**	15,763.1	97.2
Cross currency swaps	**941.6**	**103.1**	945.8	77.1
Total derivatives	**17,359.7**	**167.5**	16,708.9	174.3
Under 1 year	**4,438.9**	**8.8**	4,573.1	13.3
Between 1 and 5 years inclusive	**11,089.8**	**151.7**	10,443.0	74.3
Over 5 years	**1,831.0**	**7.0**	1,692.8	86.7
Total derivatives	**17,359.7**	**167.5**	16,708.9	174.3

Year ended
31 December 2017 **Continued**

35. Fair values

The following tables summarise the carrying amounts and fair values of those financial assets and liabilities not carried at fair value. Where available, market values have been used to determine fair values. Where market values are not available, fair values have been calculated for other financial instruments by discounting cash flows at prevailing interest rates.

31 December 2017		Fair Value Hierarchy Level	Group Carrying Value £M	Group Fair Value £M	Society Carrying Value £M	Society Fair Value £M
Financial assets:						
Cash in hand and balances with the Bank of England		Level 1	1,757.6	1,757.6	1,757.6	1,757.6
Loans and advances to credit institutions	i)	Level 2	194.0	194.0	80.9	80.9
Loans and advances to customers						
Loans fully secured on residential property		Level 3	14,908.4	15,416.0	14,908.4	15,416.0
Other loans	ii)	Level 2	54.4	51.6	54.4	51.6
Investment securities						
Loans and receivables	iii)	Level 2	15.7	15.9	15.7	15.9
Financial liabilities:						
Shares	ii)	Level 2	13,041.8	13,060.5	13,041.8	13,060.5
Amounts owed to credit institutions	iv)	Level 2	951.0	951.0	951.0	951.0
Amounts owed to other customers	ii)	Level 2	254.9	254.9	871.1	871.1
Debt securities in issue	v)	Level 1	2,672.9	2,770.7	2,702.8	3,155.7
Debt securities in issue	v)	Level 2	182.8	183.5	–	–
Subscribed capital	vi)	Level 1	25.0	25.0	25.0	25.0

Year ended
31 December 2017 **Continued**

35. Fair values continued

31 December 2016		Fair Value Hierarchy Level	Group Carrying Value £M	Group Fair Value £M	Society Carrying Value £M	Society Fair Value £M
Financial assets:						
Cash in hand and balances with the Bank of England		Level 1	938.9	938.9	938.9	938.9
Loans and advances to credit institutions	i)	Level 2	187.3	187.3	66.3	66.3
Loans and advances to customers						
Loans fully secured on residential property		Level 2	13,056.1	13,545.0	13,056.1	13,545.0
Other loans	ii)	Level 2	99.6	104.6	99.6	104.6
Investment securities						
Loans and receivables	iii)	Level 2	24.1	22.6	24.1	22.6
Financial liabilities:						
Shares	ii)	Level 2	11,123.8	11,270.8	11,123.8	11,270.8
Amounts owed to credit institutions	iv)	Level 2	572.1	572.1	572.1	572.1
Amounts owed to other customers	ii)	Level 2	357.5	357.5	1,232.8	1,232.8
Debt securities in issue	v)	Level 1	2,188.6	1,926.7	2,158.0	2,535.7
Debt securities in issue	v)	Level 2	282.6	287.4	–	–
Subscribed capital	vi)	Level 1	25.0	25.0	25.0	25.0

Fair value represents the amount for which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arm's length transaction. The following methods and assumptions have been applied in determining fair value:

i) The carrying amount of loans and advances to credit institutions, with a maturity of under 12 months, is assumed to equate to their fair value.
ii) The fair value of loans and advances to customers, shares, and amounts owed to other customers is calculated using the effective interest rate method on the discounted cash flow basis, which also includes an assessment of future credit loss where appropriate.
iii) Fair values are based on quoted market prices where available. For instruments where quoted market prices are not available the market price is based on discounted cash flows using interest rates for securities with similar credit, maturity and yield characteristics.
iv) The fair value of floating rate and overnight deposits is approximately equal to their carrying amount. The estimated fair value of fixed rate loans and deposits is based on discounted cash flows using prevailing money market interest rates for debts with similar credit risk and remaining maturity.
v) Debt securities in issue are valued by reference to their market value where an active market exists. Where no active market exists, a discounted cash flow approach is used.
vi) The fair value of subscribed capital is obtained from market prices.

Year ended
31 December 2017 **Continued**

35. Fair values continued

The following table analyses the Group's assets and liabilities by the class of financial instrument to which they are assigned under the measurement basis:

Group 31 December 2017	Fair value through Income Statement £M	Available for sale £M	Amortised cost £M	Non financial assets/ liabilities £M	Total £M
Assets:					
Cash in hand and balances with the Bank of England	–	–	1,757.6	–	1,757.6
Loans and advances to credit institutions	–	–	194.0	–	194.0
Derivative financial instruments	258.5	–		–	258.5
Loans and advances to customers:					
Loans fully secured on residential property	–	–	14,908.4	–	14,908.4
Other loans	247.7		54.4	–	302.1
Fair value adjustment for hedged risk on loans and advances to customers	12.5	–	–	–	12.5
Investment securities	–	763.0	15.7	–	778.7
Non financial assets	–	–	–	272.2	272.2
Total assets	518.7	763.0	16,930.1	272.2	18,484.0
Liabilities and equity:					
Shares	29.7	–	13,041.8	–	13,071.5
Fair value adjustment for hedged risk on shares	(5.8)	–	–	–	(5.8)
Derivative financial instruments	161.9	–	–	–	161.9
Amounts owed to credit institutions	–	–	951.0	–	951.0
Amounts owed to other customers	–	–	254.9	–	254.9
Debt securities in issue	–	–	2,855.7	–	2,855.7
Subscribed capital	–	–	25.0	–	25.0
Non financial liabilities	–	–	–	210.8	210.8
General and other reserves	–	–	–	959.0	959.0
Total liabilities and equity	185.8	–	17,128.4	1,169.8	18,484.0

Year ended
31 December 2017 **Continued**

35. Fair values continued

Group 31 December 2016	Fair value through Income Statement £M	Available for sale £M	Amortised cost £M	Non financial assets/ liabilities £M	Total £M
Assets:					
Cash and balances with the Bank of England	–	–	938.9	–	938.9
Loans and advances to credit institutions	–	–	187.3	–	187.3
Derivative financial instruments	263.1	–	–	–	263.1
Loans and advances to customers:					
Loans fully secured on residential property	–	–	13,056.1	–	13,056.1
Other loans	251.9	–	99.6	–	351.5
Fair value adjustment for hedged risk on loans and advances to customers	70.1	–	–	–	70.1
Investment securities	–	753.7	24.1	–	777.8
Non financial assets	–	–	–	284.9	284.9
Total assets	585.1	753.7	14,306.0	284.9	15,929.7
Liabilities and equity:					
Shares	109.4	–	11,092.7	–	11,202.1
Fair value adjustment for hedged risk on shares	31.1	–	–	–	31.1
Derivative financial instruments	214.4	–	–	–	214.4
Amounts owed to credit institutions	–	–	572.1	–	572.1
Amounts owed to other customers	–	–	357.5	–	357.5
Debt securities in issue	–	–	2,471.2	–	2,471.2
Subscribed capital	–	–	25.0	–	25.0
Non financial liabilities	–	–	–	182.0	182.0
General and other reserves	–	–	–	874.3	874.3
Total liabilities and equity	354.9	–	14,518.5	1,056.3	15,929.7

Year ended
31 December 2017 **Continued**

35. Fair values continued

The following table analyses the fair value measurement basis used for assets and liabilities held at fair value at the Statement of Financial Position date.

31 December 2017 Group	**Level 1 £M**	**Level 2 £M**	**Level 3 £M**	**Total £M**
Financial assets				
Derivative financial instruments	**–**	**227.2**	**31.3**	**258.5**
Loans and advances to customers	**–**	**–**	**247.7**	**247.7**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**12.5**	**12.5**
Investment securities – available for sale	**215.7**	**547.3**	**–**	**763.0**
Financial liabilities				
Shares	**–**	**29.7**	**–**	**29.7**
Fair value adjustment for hedged risk on shares	**–**	**–**	**(5.8)**	**(5.8)**
Derivative financial instruments	**–**	**70.3**	**91.6**	**161.9**

31 December 2016 Group	Level 1 £M	Level 2 £M	Level 3 £M	Total £M
Financial assets				
Derivative financial instruments	–	221.3	41.8	263.1
Loans and advances to customers	–	–	251.9	251.9
Fair value adjustment for hedged risk on loans and advances to customers	–	–	70.1	70.1
Investment securities – available for sale	298.6	455.1	–	753.7
Financial liabilities				
Shares	–	109.4	–	109.4
Fair value adjustment for hedged risk on shares	–	–	31.1	31.1
Derivative financial instruments	–	116.8	97.6	214.4

Level 1: Relates to financial instruments where quoted prices (unadjusted) in active markets can be found for identical assets or liabilities.

Level 2: Valuation techniques are used to value these instruments for which significant inputs are taken from observable market data for the asset and liability, either directly (market prices) or indirectly (derived prices) other than quoted prices included in Level 1. These include valuation models used to calculate the present values of expected future cash flows, using curves from published market sources and are employed when no active market exists or when no quoted prices for similar instruments can be obtained.

Level 3: The valuation of the asset or liability is not based on observable market data and includes unobservable inputs. Valuation techniques include net present value and discounted cash flow methods. The assumptions used in such models include risk-free benchmark interest rates, foreign currency exchange rates, equity index prices, and expected price volatilities. The objective of the valuation techniques is to determine a fair value that reflects the price of the financial instrument that would have been used by two counterparties in an arm's length transaction.

A reconciliation of the level 3 balance is provided below.

Reconciliation of level 3 fair value measurements of financial instruments

	Financial assets £M	**Financial liabilities £M**
Balance at 1 January 2017	**363.8**	**(128.7)**
Total (losses)/gains in the Income Statement	**(15.4)**	**6.0**
Movement in fair value adjustment for hedged risk on loans and advances to customers	**(57.6)**	**–**
Movement in fair value adjustment for hedged risk on shares	**–**	**36.9**
Net repayment in the year	**0.7**	**–**
Balance at 31 December 2017	**291.5**	**(85.8)**

Total gains/ (losses) for the year are included in fair value gains less losses from financial instruments in the Income Statement.

Year ended
31 December 2017 **Continued**

35. Fair values continued

Recurring fair value measurements

Financial assets/ Financial liabilities	Fair value as at 2017	Fair value as at 2016	Fair value hierarchy	Valuation technique(s) and key input(s)	Significant unobservable input(s)	Relationship of unobservable inputs to fair value
1. Investment securities (gilts and Treasury bills)	Assets – £215.7m	Assets – £298.6m	Level 1	Quoted bid prices in an active market sourced from third party data providers.	N/A	N/A
2. Investment securities (excluding gilts and Treasury bills)	Assets – £547.3m	Assets – £455.1m	Level 2	Valuations are sourced from third party data providers. The nature of these instruments means that whilst a market exists, pricing activity may be limited.	N/A	N/A
3. Interest rate swaps	Assets – £54.2m and Liabilities – £22.9m	Assets – £89.7m and Liabilities – £76.0m	Level 2	Discounted cash flow. Future cash flows are estimated based on forward interest rates (from observable yield curves at the end of the reporting period) and contract interest rates, discounted at a rate that reflects the credit risk exposure to the various counterparties.	N/A	N/A
4. Cross currency interest rate swaps	Assets – £173.0m and Liabilities – £47.4m	Assets – £131.6m and Liabilities – £40.7m	Level 2	Discounted cash flow. Future cash flows are estimated based on forward interest rates (from observable yield curves at the end of the reporting period) and contract interest rates discounted at a rate that reflects the credit risk exposure to the various counterparties. Any foreign currency amounts are translated into sterling at the contract exchange rate.	N/A	N/A
5. Equity swaps	Assets – £4.7m	Assets – £14.1m	Level 3	The assets and liabilities are equity linked derivatives with external counterparties which economically match the investment return payable by the Group to investors on equity linked savings products. The derivatives are linked to the performance of specified stock market indices and have been valued by the counterparties.	Assumption on future balance movements.	An increase in equity markets will increase the fair value of the swaps.
6. Equity release swaps	Liabilities – £64.9m	Liabilities – £69.8m	Level 3	Discounted cash flow. The liabilities are linked to equity release mortgages and are economically offset by movements in the corresponding mortgages. The valuations are provided by the counterparty and are based on a discounted cash flow model which uses a projection of interest rates, a discount rate to reflect the counterparty risk and assumptions for future mortality.	Assumptions on future life expectancy of customers based on best estimate mortality data. On this basis no reasonable alternative assumption is considered appropriate.	An increase in life expectancy will increase the value of the liability.
7. Securitisation swaps	Assets – £26.6m and Liabilities – £26.7m	Assets – £27.7m and Liabilities – £27.9m	Level 3	Discounted cash flow. The notional profile of the swaps tracks the balance of a loan portfolio which is subject to prepayment. The valuations are provided by the counterparty and are based on a discounted cash flow model which uses a projection of interest rates, a discount rate to reflect the counterparty risk and assumptions for future mortality.	Assumptions on future notional balances related to mortgage prepayment rates.	An increase in prepayment rates will change the fair value of swaps.

35. Fair values continued

Recurring fair value measurements continued

Financial assets/ Financial liabilities	Fair value as at 2017	2016	Fair value hierarchy	Valuation technique(s) and key input(s)	Significant unobservable input(s)	Relationship of unobservable inputs to fair value
8. Loans and advances to customers	Assets – £247.7m	Assets – £251.9m	Level 3	The assets are valued using the valuation of the associated derivatives as the critical terms are materially aligned and the conditions associated with the loan and derivatives match.	Assumptions on future life expectancy of customers based on best estimate mortality data. On this basis no reasonable alternative assumption is considered appropriate.	An increase in life expectancy will decrease the value of the asset.
9. Shares	Liabilities – £29.7m	Liabilities – £109.4m	Level 2	These are equity linked savings products on which the return is linked to the performance of specific stock market indices. The liabilities are valued using the valuation of the associated derivatives as all critical terms and conditions match.	N/A	N/A

For those fair value measurements classified at Level 3 above, the significant unobservable inputs have not been developed by the Society when measuring fair value and the Society is not therefore disclosing quantitative information regarding these inputs, in line with the permitted exemption in IFRS 13.

36. Events after the date of the Statement of Financial Position

There have been no other material subsequent events between 31 December 2017 and the date of approval of these Annual Report and Accounts by the Board.

Annual Business Statement

Year ended
31 December 2017

1. Statutory percentages

	31 December 2017	Statutory Limit
Lending limit	**5.1%**	25%
Funding limit	**23.8%**	50%

Explanation

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986 (as amended by the Building Societies Act 1997).

The lending limit measures the proportion of business assets not in the form of loans fully secured on residential property. Business assets are the total assets of the Group as shown in the Statement of Financial Position, plus impairment provisions for loans and advances to customers, less liquid assets and tangible fixed assets.

Loans fully secured on residential property are the amount of principal owing by borrowers and accrued interest not yet paid. This is the amount shown in the Statement of Financial Position.

The funding limit measures the proportion of shares and borrowings not in the form of shares held by individuals.

2. Other percentages

	31 December 2017	31 December 2016
As a percentage of shares and borrowings:		
Gross capital	**5.73%**	6.11%
Free capital	**5.45%**	6.01%
Liquid assets	**15.94%**	13.01%
Profit for the financial year as a percentage of mean total assets	**0.51%**	0.58%
Management expenses as a percentage of mean total assets	**0.56%**	0.62%

The above percentages have been prepared from the Group's consolidated accounts and in particular:

- 'shares and borrowings' represent the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue;
- 'gross capital' represents the aggregate of general reserve, other reserve, revaluation reserve and subscribed capital;
- 'free capital' represents the aggregate of gross capital and collective impairment provisions for loans and advances to customers less tangible and intangible fixed assets and investment properties;
- 'mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year;
- 'liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities; and
- 'management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Annual Business Statement

Year ended
31 December 2017 **Continued**

3. Information relating to the directors and other officers at 31 December 2017

Name	Occupation	Date of birth	Date first appointed
Chairman			
R J Ashton (Chairman from 26 March 2013)	Chairman	19.01.58	26.04.11
Vice Chairman			
L M Platts (Vice Chairman from 26 March 2014)	Senior Independent Director	10.02.54	26.10.10
Chief Executive			
*P A Hill	Chief Executive Officer	28.07.61	01.08.06
Directors			
P A Brown	Company Director	31.03.66	15.01.13
**S H Cooklin	Company Director	04.04.60	25.02.14
*R G Fearon	Chief Commercial Officer	16.07.78	19.02.16
D Fisher	Company Director	02.08.58	27.03.12
*A J Greenwood	Chief Risk Officer	11.12.69	08.01.15
G J Hoskin	Company Director	18.09.60	16.11.15
J A Hunt	Company Director	25.09.54	29.04.15
P A Jenks	Company Director	03.01.51	27.03.12
*R S P Litten	Chief Financial Officer	11.05.63	10.01.12
L McManus	Company Director	17.06.68	01.09.17
*K R Wint	Chief Operating Officer	02.05.65	01.12.12

(*Executive directors)

(**Retired 06.04.17)

The Society's executive director service contracts can be terminated on 12 months' notice by either the Society or the director.

Documents may be served on the above named directors at: c/o Deloitte LLP (Ref DH), 1 City Square, Leeds, United Kingdom LS1 2AL.

Details of directors – other directorships

(*Society subsidiary)

R J Ashton	Shawbrook Bank Ltd Shawbrook Group plc
P A Hill	CML Premises Ltd NewTA Ltd trading as UK Finance
P A Brown	PHD International Ltd Omnicom Media Group UK Ltd OMD International Ltd
R G Fearon	None
D Fisher	None
A J Greenwood	None
G J Hoskin	The British Diabetic Association Diabetes UK Services Ltd

Year ended
31 December 2017 **Continued**

Details of directors – other directorships continued

J A Hunt	JCH Associates Ltd
P A Jenks	Broadlands Finance Ltd Charter Court Financial Services Group Ltd Charter Court Financial Services Ltd Charter Mortgages Ltd Exact Mortgage Experts Ltd
R S P Litten	Arkose Funding Ltd Leeds Mortgage Funding Ltd*
L McManus	Doggy Day Care Academy Ltd
L M Platts	AJ Bell Holdings Ltd Lancashire County Cricket Club
K R Wint	None

Executive management

Name	Occupation	Directorships (*Society subsidiary)
K G Bassett	Chief Internal Audit Officer	None
T W Clark	Chief Information Officer	Ongo Homes Ltd
K J Green	Director of Products and Distribution	None
R Hewitt	Director of People	None
N Marsh	Director of Customer and Digital	None
A Mellor	Deputy Chief Risk Officer and Director of Prudential and Enterprise Risk	None
G M Mitchell	Director of Finance Operations	Leeds Mortgage Funding Ltd* Leeds Financial Services Ltd*
A R A Moody	Deputy Chief Risk Officer and Director of Credit Risk	None
A Port	Director of Strategy	None
M J Richardson	Director of Operations	Leeds Building Society Charitable Foundation
I P Riley	Director of Treasury	Leeds Building Society Staff Pension Scheme Ltd Estate Management 94 Ltd
T A Tinkler	Director of Change	None
K Tong	Director of Legal and Compliance and Secretary	None
S J Whittle	Deputy Finance Director	None

Country by Country Reporting

Year ended
31 December 2017

The Capital Requirements (Country by Country Reporting) Regulations 2013 introduce reporting obligations for institutions within the scope of the European Union's Capital Requirements Directive (CRD IV). The requirements aim to give increased transparency regarding the activities of institutions.

The information below has been audited in accordance with the standards required by Directive 2006/43/EC.

Nature of the Group's activities

Leeds Building Society is the UK's fifth largest building society with 55 branches (2016: 62), total assets of £18.5bn (2016: £15.9bn) and 796,000 members (2016: 756,000).

The consolidated entities, their country of incorporation and their principal activities are detailed in note 13 on page 108. The Group has regulatory branches in Gibraltar and the Republic of Ireland and their results are included within the Group.

Total income, profit before tax, average number of employees and staff costs

The information for the year ended 31 December 2017 presented below is at a full Group level of consolidation, which has been prepared under IFRS. Total income is defined as net interest income plus fees and commissions receivable (net of fees and commissions payable), fair value gains less losses from financial instruments, together with all other components of operating income. Average monthly number of employees is shown on a full time equivalent basis. Staff costs comprise wages and salaries, social security costs and other pension costs.

Total income of £221.0m (2016: £212.0m) and profit before tax of £120.9m (2016: £116.6m) are as disclosed in the Group's Income Statement on page 90. Total staff costs of £56.7m (2016: £53.9m) are as disclosed in note 6 on page 101.

	UK	Spain	Republic of Ireland	Total
Total income (£m)	219.4	0.6	1.0	221.0
Profit before tax (£m)	122.3	(0.2)	(1.2)	120.9
Average number of FTEs	1,320	–	2	1,322
Staff costs (£m)	56.6	–	0.1	56.7

Return on assets

The return on assets, calculated as profit before tax divided by mean total assets, was 0.70% (2016: 0.79%) for the year ended 31 December 2017.

Corporation tax paid

The Group made payments of £30.8m (2016: £27.1m) in respect of corporation tax during the year ended 31 December 2017. This was wholly payable to HM Revenue & Customs in the UK.

Public subsidies received

The Group received no public subsidies in the year ended 31 December 2017.

Glossary of Terms

Year ended
31 December 2017

Set out below are the definitions of the terms used within the Annual Report and Accounts to assist the reader and to facilitate comparison with other financial institutions. Included are details of Alternative Performance Measures (APMs) used within the Annual Report and Accounts, with an explanation of how the APM is calculated and a reconciliation to the closest equivalent statutory measure, as defined or specified under International Financial Reporting Standards.

Arrears
A customer is in arrears when they are behind in fulfilling their obligations with the result that an outstanding loan commitment is overdue. Such a customer can also be said to be in a state of delinquency.

Basel III
Basel III is the third capital adequacy framework issued by the Basel Committee on Banking Supervision, which defines the capital and liquidity rules for Banks and Building Societies. The framework has been embedded into UK law through the European Capital Requirements Directive IV (CRD IV).

Basis point
One hundredth of a per cent (0.01%), so 100 basis points is 1%. Used in quoting movements in interest rates or yields on securities.

Commercial lending
Loans secured on commercial property.

Common Equity Tier 1 (CET1) ratio
This is a regulatory ratio, calculated as the total of CET1 capital divided by Risk Weighted Assets (RWAs). CET1 capital is the highest quality form of capital and comprises general reserves from retained profits, less the book values of any pension surplus, goodwill and intangible assets and other regulatory adjustments as defined under CRD IV.

Contractual maturity
The final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal and interest is due to be repaid.

Cost to income ratio
An APM, the cost to income ratio is a measure of the efficiency of the Society by measuring costs in relation to income generation. It is calculated as management expenses (see below) divided by total income, as recorded in the Income Statement. There is no equivalent statutory measure, but all elements of the calculation are statutory measures.

Cost to mean asset ratio
The cost to mean asset ratio is an APM, and is another measure of the efficiency of the Society by measuring costs in relation to the value of assets. It is calculated as management expenses divided by mean total assets. There is no equivalent statutory measure, although all elements of the calculation are statutory measures.

Covered bonds
Debt securities backed by a portfolio of mortgages that is segregated from the issuer's other assets solely for the benefit of the holders of the covered bonds. The Group issues covered bonds as part of its funding activities.

Credit risk
This is the risk that a customer or counterparty is unable to pay the interest or to repay the capital on a loan when required.

Credit risk weighted amount
The notional value of derivative contracts adjusted to determine their inherent credit risk using PRA predetermined risk weights.

Debt securities
Assets held by the Group representing certificates of indebtedness of credit institutions, public bodies or other undertakings excluding those issued by central banks.

Debt securities in issue
Transferable certificates of indebtedness of the Group to the bearer of the certificates. These are liabilities of the Group and include certificates of deposit.

Delinquency
See Arrears.

Derivative financial instruments
A derivative financial instrument is a type of financial instrument (or an agreement between two parties) whose value is based on the underlying asset, index or reference rate to which it is linked. The Group uses derivative financial instruments to hedge its exposures to market risks, such as interest rate and currency risk.

Effective interest rate method (EIR)
The method used to measure the carrying value of a financial asset or a liability and to allocate associated interest income or expense to produce a level yield over the relevant period.

Fair value
Fair value is 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 compensation fund of last resort for customers of authorised financial services firms. The FSCS may pay compensation to customers if a firm is unable, or likely to be unable, to pay claims against it, usually because it has stopped trading or has been declared in default. The FSCS is funded by the financial services industry. Every firm authorised by the FCA and PRA is obliged to pay an annual levy, which goes towards its running costs and compensation payments.

Forbearance strategies
Strategies to assist borrowers in financial difficulty, such as agreeing a temporary reduction in payments, extending loan terms and temporarily converting loans to an interest-only basis. Forbearance strategies aim to avoid repossession where it is in the interest of the borrower.

Free capital
The aggregate of gross capital and provisions for collective impairment losses on loans and advances to customers less property, plant and equipment and intangible assets.

Funding limit
Measures the proportion of shares and borrowings (excluding the fair value adjustment for hedged risk) not in the form of shares held by individuals.

General reserves
The accumulation of the Group's post-tax profit since inception. It is the Group's main component of Common Equity Tier 1 capital which is a measure of strength and stability.

Gross capital
The aggregate of general reserve, other reserve, revaluation reserve and subscribed capital.

Gross (new) residential lending
This is an APM, and represents the total amount of new loans and advances to customers secured on residential property advanced by the Society in the year. There is no equivalent statutory measure.

Impaired loans
Loans where there is objective evidence that an impairment event has occurred, meaning that the Group does not expect to collect all the contractual cash flows or expect to collect them when they are contractually due.

Individually/collectively assessed
Individual assessments are made of all mortgage loans where objective evidence indicates losses are likely or the property is in possession. A collective impairment provision is made against the remaining group of loans and advances where it is likely that losses may be realised, but those losses cannot be attributed to individual accounts.

Internal Capital Adequacy Assessment Process (ICAAP)
The Group's own assessment, as part of Basel II requirements, of the levels of capital that it needs to hold in respect of regulatory capital requirements for risks it faces under a business-as-usual scenario and a number of stressed scenarios.

Internal Liquidity Adequacy Assessment Process (ILAAP)
The Group's own internal assessment of the level of liquidity that it needs to hold in respect of regulatory liquidity requirements in relation to a number of stressed scenarios.

International Swaps and Derivatives Association (ISDA) master agreement
A standardised contract developed by ISDA and used to enter into bilateral derivatives transactions granting legal rights of offsetting for derivative transactions with the same counterparty.

Law of Property Act (LPA) receiver
LPA Receivers are appointed by the Group to deal with the management and disposal of commercial property held as security for loans in default.

Lending limit
Measures the proportion of business assets not in the form of loans fully secured on residential property.

Leverage ratio
A regulatory ratio which measures the value of the Society's Tier 1 capital as a proportion of total relevant non-risk weighted assets. The CRR leverage ratio is defined by the EU's Capital Requirements Regulation, while the UK leverage ratio modifies this ratio to exclude Central Bank reserves.

Liquid assets
Total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, and investment securities.

Liquidity Coverage Ratio (LCR)
A regulatory standard ratio implemented by the Basel III Reforms. It is calculated as the stock of high quality liquid assets divided by the total net stressed cash outflows over the next 30 calendar days expressed as a percentage. The measure is being phased in gradually with full compliance required by 1 January 2018.

Liquidity risk
The risk that the Group is not able to meet its financial obligations as they fall due, or will have to do so at an excessive cost. This risk arises from timing mismatches of cash inflows and outflows.

Loan to value ratio (LTV)
A ratio which expresses the amount of a mortgage as a percentage of the value of the property. The Group calculates residential mortgage LTV on an indexed basis (the value of the property is updated on a quarterly basis to reflect changes in the house price index (HPI)).

Loans past due/past due loans
Loans are past due when a counterparty has failed to make a payment when contractually due.

Management expenses
Management expenses represent the aggregate of administrative expenses, depreciation and amortisation as recorded in the Income Statement.

Market risk
The risk that movements in market risk factors, including foreign exchange rates, interest rates and customer-driven factors will create losses or decrease portfolio values.

Mean total assets
Represents the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.

Member
A person who has a share investment or a mortgage loan with the Society which satisfies the Society's rules for membership.

Minimum requirement for Own Funds and Eligible Liabilities (MREL)
MREL is the total loss absorbing capital a financial institution must hold to facilitate the recapitalisation of the institution in resolution.

Mortgage backed securities (MBS)
A category of asset backed security that represent interests in a group of mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).

Net interest income
The difference between interest received on assets and similar income and interest paid on liabilities and similar charges.

Net interest margin
An APM calculated as net interest income, divided by mean total assets. There is no equivalent statutory measure, although the APM is fully derived from statutory measures.

Net Promoter Score®
The Net Promoter Score® is a measure of customer loyalty to the Group.

Net residential lending
This is an APM which represents the increase in the size of the residential mortgage book during the year. It is calculated as gross residential lending, less redemptions, contractual repayments and other capital repayments. The closest statutory measure is the movement in loans fully secured on residential property in the Statement of Financial Position. The main reconciling items to the statutory measure are the movements in impairment losses and EIR adjustments.

Net Stable Funding Ratio (NSFR)
A regulatory standard ratio implemented by the Basel III reforms which is the total amount of stable funding divided by the total amount of required stable funding, expressed as a percentage. The NSFR is currently an observable measure which is intended to become a minimum standard in the future.

Notional principal amount
The notional principal amount indicates the amount on which payment flows are derived at the Statement of Financial Position date and does not represent amounts at risk.

Operational risk
The risk of loss arising from inadequate or failed internal processes, people and systems or from external events.

Permanent interest bearing shares (PIBS)
Unsecured deferred shares that are a form of capital. PIBS rank behind the claims of all subordinated debt holders, depositors, payables and investing members of the Group. Also known as subscribed capital.

Replacement cost
The amount the Group would need to replace derivative contracts that are favourable to the Group if the counterparty with whom the contract was held were unable to honour their obligation.

Repurchase agreements (Repo)
A repurchase agreement allows a borrower to use a financial security as collateral for a cash loan at a fixed rate of interest. In a repo, the borrower agrees to sell a commitment to repurchase the asset at a specified price on a given future date. For the party selling the security and agreeing to repurchase the asset in the future, it is a repo.

Residential loans
Loans that are made to individuals rather than institutions and which are secured against residential property.

Residential mortgage backed securities (RMBS)
A category of asset backed security that represent interests in a group of residential mortgages. Investors in these securities have the right to cash received from future mortgage payments (interest and/or principal).

Risk appetite
The articulation of the level of risk that the Group is willing to take (or not take) in order to safeguard the interests of the Group's members whilst achieving business objectives.

Risk Weighted Assets (RWAs)
A regulatory measure which adjusts the value of assets as recorded in the Statement of Financial Position to reflect the relative level of risk. This measure is used in calculating regulatory capital requirements.

Shares
Money deposited by a person in a retail savings account with the Group. Such funds are recorded as liabilities for the Group.

Shares and borrowings
This is a measure of indebtedness which represents the total of shares, amounts owed to credit institutions, amounts owed to other customers and debt securities in issue.

Solvency ratio
Measures the Group's reserves as a proportion of its risk weighted assets.

Sovereign debt
Bonds issued by a national government. Historically sovereign debt has been viewed as less risky than other forms of debt issued.

Subscribed capital
See permanent interest bearing shares (PIBS).

Tier 1 capital
A measure of financial strength as defined by the PRA. Tier 1 capital is divided into Common Equity Tier 1 and other Tier 1 capital. Common Equity Tier 1 capital is defined above, while other Tier 1 capital includes qualifying capital instruments such as PIBS.

Tier 2 capital
A further component of regulatory and financial capital as defined by CRD IV which for the Society is represented by certain impairment provisions.

Wholesale funding
The total of amounts owed to credit institutions, amounts owed to other customers and debt securities in issue less balances deposited by offshore customers.

Get in touch

Find your nearest branch
www.leedsbuildingsociety.co.uk/branch

UK-based contact centre
Call **03450 50 50 75**
8am–8pm, 7 days a week

We may monitor and/or record your telephone conversations with the Society to ensure consistent service levels (including colleague training).

Leeds Building Society