Leeds Building Society

Annual Report & Accounts 2018

Leeds Building Society

Committed to your future

2018: a year in review

Gross residential lending exceeded
£3.8bn
(2017: £4.1bn)

We helped over **43,000** more people have the home they want.

Total assets up 5% to
£19.4bn
(2017: £18.5bn)

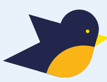
Record savings balances up 6% to
£13.9bn
(2017: £13.1bn)

We helped over **63,000** more people save for their future.

We paid an average of
1.32%
to our savers compared to the rest of market average of 0.70%

An annual benefit to all our savers of **£81.5m**.

Profit before tax
£116.9m
(2017: £120.9m)

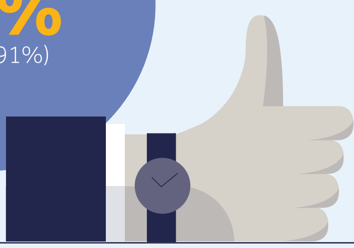


Common Equity Tier 1 Capital is
31.3%
(2017: 14.5%)

Reserves available to protect us from future problems.

Customer satisfaction
91%
(2017: 91%)

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



Colleague engagement score up 1% to
81%
(2017: 80%)

We are committed to being a great place to work.

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31 December 2018

Strategic Report
Chairman's Welcome

Leeds Building Society continued to perform strongly in 2018, despite the ongoing uncertainty around the UK's future relationship with Europe. We continue to help people save and have the home they want through good value products and improved service to our members.

As a result, membership is now more than 800,000 and assets increased by 5%, to £19.4 billion. Our lending growth, combined with a focus on efficiency and managing costs, led to a strong level of profit, enabling us to increase our capital and invest further in the long term future of your Society.

Economic background

The UK's expected departure from the EU has dominated the economic landscape for the past two years and is likely to do so for some time to come. The full impact of Brexit is unclear as markets remain unpredictable and consumer confidence subdued.

Growth of the UK economy slowed in 2018[1] but despite this, unemployment levels remain at near record lows[2] and wage growth has started to pick up[3], alleviating some of the pressure on disposable incomes. Inflation, which peaked at 3.1% in November 2017, fell to 2.0%[4] at the end of 2018 and is expected to remain around this level over the coming months[5].

In July last year, the Bank of England increased Bank Base Rate (BBR) to 0.75%, its highest level for a decade, but still well below pre-crisis norms[6]. In the absence of any significant financial shocks to the economy, market expectations are for BBR to increase modestly with any future tightening of monetary policy to be gradual and to a limited extent[7].

Demand from customers for new mortgages has remained somewhat muted. Gross mortgage lending in the UK reached £269 billion[8], up 3% year-on-year, but still above the pace of house price inflation which, according to the Halifax House Price Index, was 1.3% – its lowest for a full year since 2012[9].

As a result, competition in the mortgage market has intensified and average new mortgage rates relative to BBR fell during 2018[10]. At the same time, savers have benefitted from an increase in market rates since the start of the year[11] bringing some relief following a sustained period of historically low interest rates.

These developments had been anticipated and the Society's business model allows it to continue to perform well in these circumstances.

Regulation

The busy regulatory agenda shows no sign of abating. In May 2018, the General Data Protection Regulation came into force designed to provide consumers with greater control over their personal data. We updated and refined our existing policies, standards and procedures to be able to meet the new regulatory requirements.

In July, the Bank of England, Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) published a joint discussion paper focusing on improving the operational resilience of firms and financial market infrastructures. This remains a key priority for the Society and is managed through a programme of continuous improvement and investment.

The Bank of England also introduced changes to discontinue the use of the London Interbank Offered Rate (LIBOR). We have already started to assess the possible impact so we can prepare for the changes, which come into effect in 2021.

During 2018, the FCA launched a consultation on fair pricing for consumers and better access to products and services. We are already committed to providing the right competitively priced products for members and will continue to review our products in line with any emerging regulatory guidance.

Regulation impacting the capital and liquidity requirements applicable to the Society continues to evolve, including EU amendments to the Capital Requirements Directive IV and the Capital Requirements Regulation. The Society is well capitalised and expects to be able to fully meet the regulatory requirements.

Chief Executive Officer succession

Peter Hill, who was appointed Chief Executive Officer in 2011, advised the Board in August last year of his plan to retire in February 2019.

I would like to thank Peter for his outstanding vision and leadership over the past seven years, during which time the Society's total assets and profits have more than doubled. He has made a huge contribution to our success and I wish him well for the next stage in his life.

Peter will be succeeded by Richard Fearon, who is currently the Society's Deputy Chief Executive Officer.

Before joining the Society, Richard spent 10 years with Lloyds Banking Group, where he held a number of senior roles in both the mortgage and savings businesses. He started his career at management consultants Oliver Wyman & Company.

Richard was recruited three years ago with succession in mind and during his time with us, has proved to be an extremely able executive director. He will become only the eighth CEO in our 144-year history and I know he will lead the business and our colleagues to future success, particularly as we continue to develop a Society capable of thriving in the digital age.

Summary

Competition in our core markets intensified in 2018 and we expect this to persist for the foreseeable future. We also anticipate continued uncertainty around the UK's departure from the EU.

Nonetheless, our strategic approach to sustainable growth means we're well-placed to withstand any economic shocks and continue to invest in the long term future of the Society.

Members will remain at the centre of everything we do and we will carry on looking after your interests so you can share in the benefits of our security and success.

Finally, on behalf of the Board, I would like to thank our skilled and dedicated colleagues, who continue to deliver outstanding service and you, our members, for choosing to be part of our successful and independent building society.

Robin Ashton
Chairman

26 February 2019

1. Office of National Statistics – Annual GDP growth in 2018 was 1.4% (vs. 1.8% in 2017), its lowest rate since 2012.
2. Office of National Statistics – ILO unemployment rate 4.0% (October-December 2018)
3. Office of National Statistics – Average weekly earnings 3 month average (December 2018: 3.4%)
4. Office of National Statistics – CPI inflation December 2018
5. Bank of England – February 2019 Inflation Report inflation projections
6. Bank of England – Official Bank Base Rate history data
7. Bank of England – Inflation Report, February 2019
8. UK Finance – Gross mortgage lending for the 12 months to December 2018
9. Halifax HPI – Annual change as at December 2018
10. Bank of England – The average new mortgage rate in November 2018 (2.50%) is lower than at the start of the year (2.55%) despite a 0.25% increase in Bank Base Rate
11. Bank of England – Average effective time deposit rates for new business

Chief Executive Officer's Highlights

Year ended
31 December 2018

In my final report as Chief Executive Officer, I'm proud to report that we've once again delivered on our mission to help people save and have the home they want. Savings, mortgage balances and assets and capital are all at record levels.

Supporting the aspirations of borrowers and savers

Throughout 2018, we worked hard to provide security and value to all our members, as we balance the needs of both savers and borrowers through a range of actions.

Savers have seen interest returns increase following a period of historically low rates, and we've continued to support them during this time, offering products to meet their needs. We paid an average 1.32% to our savers compared to the rest of market average of 0.70%[1], which equates to an annual benefit to our savers of £81.5 million.

Our support for savers was recognised with the 'Best Building Society Savings Provider' award for the third year running from the independent comparison site, Moneyfacts.

Notwithstanding the increase in Bank Base Rate last year, competition in the mortgage market meant new mortgage rates reduced during 2018. Our ability to attract savers has enabled us to keep growing our mortgage lending and focus on customers less well served by the wider market, as well as mainstream borrowers.

We continued to support first time buyers through a number of key segments including Shared Ownership, Affordable Housing and Help to Buy, which resulted in us helping almost 12,000 people buy their first home.

Our consistent approach was recognised by What Mortgage magazine and we were awarded the accolade of 'Best Shared Ownership Lender' for the third consecutive year.

Drawing on our experience in the Interest Only market, combined with extensive research into borrowers' needs as they age, we were the first national high street lender to offer older borrowers more choice by launching a new Retirement Interest Only mortgage range.

We remained active in the Buy to Let market, launching innovative products such as our Easy Start mortgage, as well as simplifying lending criteria and strengthening our specialist underwriting team.

Our understanding of the wider mortgage market and expertise in lending to homebuyers, movers and re-mortgagors resulted in the Society being named 'Best Building Society' at the Your Mortgage awards.

Continuing financial security

Our focus on under-served segments of the mortgage market has delivered sustained growth and good quality lending. This, combined with keen cost control has resulted in profit before tax of £116.9 million, which reduced from £120.9 million a year earlier, primarily as a result of the one-off impact of the sale of our Irish mortgage book (£6.5 million).

High levels of employment and the sale of our Irish mortgage book has resulted in residential arrears[2] reducing to 0.46% in 2018, which means fewer than one in 200 borrowers is experiencing difficulty paying their mortgage. We also continued to manage down our commercial lending portfolio and these loans now represent less than 0.2% of all loans to customers.

In 2018, we secured an Internal Ratings Based (IRB) permission from the Prudential Regulation Authority (PRA). By granting this permission, the PRA has confirmed the Society is able to assess its own capital requirements for credit risk. This permission reflects how we measure, manage and control risk effectively, and empowers better business decisions as well as further enhancing our capital resilience.

We raised £200 million of capital as part of our plan to meet Minimum Requirement for Own Funds and Eligible Liabilities (MREL), which we expect to do well ahead of the 2022 regulatory timeframe. This, combined with a good level of profit, meant we were able to increase our capital to £1.2 billion, well above the regulatory minimum requirements.

We encountered high levels of competition last year, particularly in the mortgage market, which we expect to continue. Combined with the uncertainty surrounding the UK's exit from the EU, this is likely to put further downward pressure on our net interest margin as we move through 2019 and beyond.

However, our robust performance and high levels of capital mean we have a strong Society and remain well-placed to withstand economic uncertainty, protect our members' money and keep growing sustainably.

Delivering outstanding personal service

By focusing on what matters to members and brokers, who introduce the majority of our mortgage business, we've further improved the customer experience we provide.

Savings members are now able to manage their accounts more easily following a number of enhancements to our online functionality. They can complete more transactions through the secure messaging service, reset passwords, update key information and take steps to increase the security of their account.

We've also further improved the savings account maturity process to offer greater flexibility in how our members can provide instructions in advance of when their funds become available.

My colleagues are committed to delivering the best and they were outstanding last year. Regular reviews show they are highly engaged and I'd like to thank them for their passion and commitment to serving our members.

As a result, our KPMG Nunwood Customer Experience Excellence ranking[3] went from 107th in 2017 to the equivalent of 53rd last year, and we were one of only two top 15 financial services brands to improve our score and ranking for two consecutive years.

We also achieved a 2* Best Companies rating, highlighting us as an 'employer of choice' with an outstanding commitment to workplace engagement and this means we are in the 2019 Sunday Times Top 100 Best Companies to Work For. Fairer Finance also awarded us its 'Gold Ribbon' for savings accounts based on customer happiness and trust, along with our ability to explain things clearly.

Investing in the Society

Our branch network continues to evolve and plays an important role in attracting the retail savings needed for us to be able to help people have the home they want.

Following feedback from our members, and the successful opening of our Bournemouth branch in 2017, we opened our first branch in Edinburgh. We invest a great deal of time and effort to identify the best locations and this adds further choice for savers on the high street.

I'm delighted we were able to relocate our Moortown branch to a larger property so close to our previous premises.

1. CACI CSDB, Stock, January 2018 – December 2018, latest data available. CACI is an independent company that provides financial benchmarking data and covers 87% of the high street cash savings market
2. 1.5% or more of outstanding mortgage balances
3. KPMG Nunwood UK's overall Customer Experience Excellence Performance Top 100-ranking score equivalent to 53rd in the Top 100, sample size slightly lower than threshold for inclusion in Top 100 table

Chief Executive Officer's Highlights

Year ended
31 December 2018

Continued

This meant we could keep the old branch open for the benefit of our members while we refurbished the new building, and we've also increased the number of colleagues serving customers.

These branches have been designed to improve the customer experience and service we provide, and demonstrate our commitment to providing face-to-face service where there is sufficient demand.

I have previously reported that we had outgrown our current Head Office in Leeds and secured a new office building that keeps us in the heart of the city. The project to design the office space, move colleagues and further develop our IT infrastructure is underway and is an important investment for the future.

We're also continuing to improve our digital capability as we strive to meet the changing needs of our members. We've successfully enhanced our online savings proposition and focus on this important area will continue, as will our investment to improve our mortgage processing capability.

Through our focus on efficiency, we are able to continue to balance the need to invest in your Society, while controlling costs and growing sustainably. We anticipate our cost to income ratio of 44.8% and cost to mean asset ratio of 0.52% will remain among the best in the building society sector.

Your Society is proud to be the first financial services organisation to receive Leaders in Diversity accreditation from the National Centre for Diversity, demonstrating a strong commitment to diversity and inclusion and attracting and retaining the best talent.

I'm also very proud to report that we became the first national high street financial institution certified as an accredited Fair Tax Mark[4] business, having been successfully assessed against the Fair Tax Mark criteria. We recognise the public services paid for through tax benefit our members, colleagues and communities, and help create the strong foundations we need to thrive as a business in the long term. That's why we're committed to doing the right thing, paying our fair share and reporting our tax affairs transparently to our stakeholders.

Outlook

Our strong performance over many years has resulted in record retained capital and reserves and we have further consolidated our financial strength.

Uncertainty around the UK's exit from the EU will remain, and competition in our core markets of savings and mortgages is expected to continue. Notwithstanding this, we are very well placed to continue to act in the long term interests of the Society and deliver sustainable growth for the benefit of you, our members.

It's been a great privilege to be the custodian of your Society as only the seventh Chief Executive Officer (CEO) in our 144-year history. During my tenure, my colleagues and I have created more than 440 high quality jobs and grown sustainably by helping more members than ever before save and have the home they want.

I'm particularly proud of the way we've helped those people less well served by the wider market to achieve home ownership, many for the first time, and by the way we've developed our approach to doing the right thing for our members, colleagues and communities.

I leave the Society stronger than ever and in very good hands. I'm delighted Richard Fearon was chosen by the Board as my successor – he has really demonstrated his value to the Society since joining the executive team and has the experience and capability to lead the business through the next stage of its development.

Finally, and for the last time, I would like to thank you, our members for the support you have given me during my seven years as CEO and your continued support for the Society.

Peter Hill
Chief Executive Officer
26 February 2019

4. Fair Tax Mark – A business with the Fair Tax Mark is certified as paying the right amount of tax in the right place at the right time and applying the gold standard of tax transparency

We've once again delivered on our mission to help people save and have the home they want. Savings, mortgage balances and assets and capital are all at record levels.

Business Model

Year ended
31 December 2018

Leeds Building Society is the fifth largest building society in the UK, with assets of £19.4 billion. As a member-owned mutual, the Society's mission is to help people save and have the home they want. This is delivered through a straightforward business model:

Where the Society's funding comes from

- Savers (via its branch network, phone, online, post)
- Wholesale markets
- Reserves of previous profits

How the Society uses its funding

The Society lends to help members have the home they want, including:

- Mainstream residential
- First time buyers
- Shared ownership
- Buy to let

How the Society remains financially stable and operationally resilient

- By maintaining liquid investments with strong credit rated institutions and central banks
- By making sufficient profit to maintain a strong capital base
- By maintaining a strong long term credit rating
- By maintaining a multi-channel business model
- Ongoing investment and focus on operational resilience, including a robust cyber strategy

What the Society needs to spend

- Costs of running the business and providing the right level of service (e.g. paying its people, property and operating costs, ensuring spending is done in an efficient way)
- Putting money aside for bad debts
- Paying taxes

Why the Society needs to make profit

The Society is member-owned and does not pay shareholder dividends, however it needs to make profit to:

- Maintain financial strength
- Invest in the Society for the benefit of members (e.g. maintaining its branch network, improving digital capability and customer experience)
- Provide benefits for the communities in which it operates

The Society funds the majority of mortgage lending with members' savings, by retaining a strong retail franchise and being a trusted provider of a range of competitive savings products. The Society funds the remainder from wholesale money markets on competitive terms and across a range of instruments and durations.

The Society provides residential (including buy to let) mortgages in the UK and Gibraltar through a network of approved mortgage brokers and via online and direct telephone services. It offers mortgage products across a range of segments, such as shared ownership, retirement interest only and holiday let.

Liquidity is maintained in excess of regulatory requirements, and is 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 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, so that the Society can price competitively to provide value to existing members, while attracting new borrowers and savers. The Society continues to invest to improve customer experience, build digital capability, maintain branches, and enhance the colleague environment.

Delivering value to members and other stakeholders

The Society delivers value to members and other stakeholders in a range of areas:

- A strong capital base is maintained to ensure long term security for members and other stakeholders. A prudent approach to lending, plus strong and sustainable profitability, help ensure the Society can meet the necessary capital requirements and provide value to members, bondholders and communities over the longer term.
- Competitive products are offered to members, with savings rates which remain higher than the market average.
- The Society helps families and first time buyers to purchase homes. A focus on customer needs means the Society can lend to borrowers in smaller segments, which are typically less well served by the wider market.
- The highest standards of trust and integrity are observed in all engagement with members and other stakeholders. This, along with competitive products and investment in the Society, helps build member and broker satisfaction and strong long term relationships.
- High levels of customer service are maintained. The Society recognises the strength of human relationships to members and is committed to maintaining its branch network, whilst also investing in digital solutions for those members who want it.
- The Society donates to community projects and charities within the communities in which its branches operate. Colleagues are given up to 14 hours of volunteering leave per year, so they can give their time to help local charitable causes, as well as helping to raise money for Samaritans, the Society's charity partner.

Society values

Society values explain the behaviours which all colleagues are expected to display in everything they do. These values underpin the delivery of the Society's business model and strategy.

Collaborative
nurturing positive relationships

Straightforward
doing the right thing

Progressive
always moving forward

Integrity
trusted custodians

Passionate
determined to succeed

Responsible
taking personal ownership

Business Model

Year ended
31 December 2018

Continued

Strategic priorities

The Society has a vision of becoming Britain's most successful building society and focuses on four strategic pillars. 2018 has been a year of very good progress.

Strategic pillars	How this is delivered	Progress in 2018
Customer focused To support the aspirations of a targeted range of borrowers and savers focused on where our expertise adds significant value.	The Society has been a mutual organisation for 144 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 systems and risk management capabilities are used to meet customer needs in areas which have historically been less well served, while competitive savings products offer members long term value.	• Savings rates in the market began to rise following the August increase in Bank Base Rate. The Society continued to pay higher savings rates than the market average and has been able to retain significant maturing balances, helping to grow savings balances to a record level. • Gross mortgage lending was £3.8 billion and was above the Society's natural market share. • The Society continues to work on enhancing its digital proposition for both members and brokers. • The Society launched a new Retirement Interest Only proposition via brokers in July, offering older customers more choice when considering their lifestyle and retirement options. The new Smart Saver savings account also launched this year was developed using customer research.
Secure To generate strong levels of profit, through optimising our lending to continue to build a sound capital base.	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, while maintaining a secure Society for members. Risks are managed through investing in colleagues and technology. The Society has developed 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.	• The Society's net interest margin reduced, as margins on new lending continued to fall and the proportion of balances paying Standard Variable Rate reduced. However, a strong profit performance has helped to improve our capital position and financial strength. Common Equity Tier 1 and leverage ratios remained well above regulatory requirements. The Society's future capital and funding plans incorporate its expected MREL requirements. • The Society has been granted an IRB permission for the management of credit risk by the Prudential Regulation Authority. • Improved financial stability through further reducing legacy portfolios, via the sale of the Irish mortgage portfolio and running down the commercial mortgage portfolio. • A number of projects have been undertaken to ensure the Society continues to comply with its regulatory obligations, such as General Data Protection Regulation (GDPR) and cheque imaging. Non-regulatory projects completed during the year include IT resilience and cyber security.
Service driven To deliver outstanding personal service across all channels supported by access to colleagues when desired.	Strong relationships exist with the Society's approved network of mortgage brokers. Processes are being developed, supported by flexible systems, so that members can engage with the Society via their chosen method of communication. Outstanding personal service is delivered by highly-engaged colleagues across the Society.	• Colleague engagement improved this year, and the Society's leadership score was maintained. It continues to be in the top quartile for the financial services industry. The Society gained a 2* award in the Best Companies survey. • The Society achieved a score equivalent to 53rd in the annual Nunwood Customer Experience Excellence survey and within the top 10 for financial services. • As a result of the review of the branch network, a new branch was opened in Edinburgh and the Moortown branch was relocated to a larger premises.
Efficient To adapt our operating model as markets and needs change, whilst being intolerant of waste.	The Society maintains a resilient and scalable core administration system platform. 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. • Work is continuing on the new Head Office building, which will reduce the current three Leeds city centre locations to a single site.

Key Performance Indicators

The Society measures its performance[1] against a number of key performance indicators.

These measures include both financial measures as defined under International Financial Reporting Standards (IFRS) and other measures as defined below. They are reported to the Board on a monthly basis and are considered to provide a balanced view of the Society's performance against its strategic priorities. The only change from the measures reported in the prior year is the UK leverage ratio is used instead of the CRR leverage ratio, in line with internal reporting.

Customer focused

Key performance indicator	What is measured	Performance	2018 update
New (gross) residential lending	The value of residential lending advanced by the Society during the year, including loans for house purchases, remortgages and further advances.	**2018** £3.8bn **2017** £4.1bn **2016** £4.0bn **2015** £3.1bn **2014** £2.7bn	The Society targeted lower growth in 2018, reflecting a more competitive market. New lending remained ahead of natural market share[2], driven by a strong product proposition and focus on key segments.
Net residential lending	Gross residential lending, less repayments of principal and redemptions. Note this measure does not include the sale of the Irish mortgage portfolio.	**2018** £1.0bn **2017** £1.8bn **2016** £1.9bn **2015** £1.4bn **2014** £1.1bn	An expected increase in redemptions over previous years drove a reduction in net lending. Mortgage balances grew by 6% through strong gross lending performance.
Savings balances	The value of shares and deposits held by the Society's members and other customers as reported in the Statement of Financial Position.	**2018** £13.9bn **2017** £13.1bn **2016** £11.2bn **2015** £9.9bn **2014** £9.2bn	Lower savings growth was targeted in 2018 reflecting the lower growth in mortgage balances.
Society membership[3]	The number of Society members. Increasing the number of members is part of achieving the Society's vision.	**2018** 804,000 **2017** 791,000 **2016** 751,000 **2015** 719,000 **2014** 697,000	Growth in mortgage and savings balances was accompanied by an increase in membership to a record level.

Secure

Key performance indicator	What is measured	Performance	2018 update
Profit before tax	Profit before tax, as reported in the Income Statement, creating capital to support future business growth.	**2018** £116.9m **2017** £120.9m **2016** £116.6m **2015** £108.5m **2014** £80.9m	Profit before tax reduced by £4.0 million, after a £6.5 million loss on the sale of the Irish mortgage portfolio.

1. Key performance indicators refer to the performance of the Group.
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.
3. The methodology for calculating the number of members has been refined in 2018. The chart reflects the new methodology, including restatement of 2017 and 2016 for comparative purposes.

Key Performance Indicators

Year ended
31 December 2018

Continued

Key performance indicator	What is measured	Performance	2018 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.	**2018** 1.15% **2017** 1.24% **2016** 1.37% **2015** 1.62% **2014** 1.58%	Net interest margin continues to reduce, as expected, due to lower margins on new business reflecting competition in the mortgage market and a reduction in the proportion of balances paying Standard Variable Rate (SVR).
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.	**2018** 214% **2017** 198% **2016** 179% **2015** 194% **2014** 196%	The Society maintained levels 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.	**2018** 31.3% **2017** 14.5% **2016** 15.2% **2015** 15.5% **2014** 15.6%	The level of capital required to be held reduced as a result of the Society being granted IRB permission as this significantly reduced RWAs. CET1 capital now exceeds £1 billion.
UK leverage ratio[4]	Another measure of capital strength. Measured as the Society's Tier 1 capital as a proportion of relevant total assets excluding central bank reserves.	**2018** 5.5% **2017** 5.5% **2016** 5.6% **2015** 5.8% **2014** N/A	Leverage ratio maintained through strong profit generation supporting controlled growth in assets. 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 (2017:A3) Short term: P2 (2017: P2) **Fitch:** Long term: A- (2017: A-) Short term: F1 (2017: F1)	The Society has maintained its strong long term 'A' credit rating with both agencies.
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.	**2018** 16 **2017** 16 **2016** 19 **2015** 22 **2014** 23	Overall turnaround time is in line with 2017, with the underwriting time to offer reduced by almost one day following receipt of a correctly packaged application.

4. Basis for calculating UK leverage ratio changed in 2017; earlier years have been restated to be on an equivalent basis.

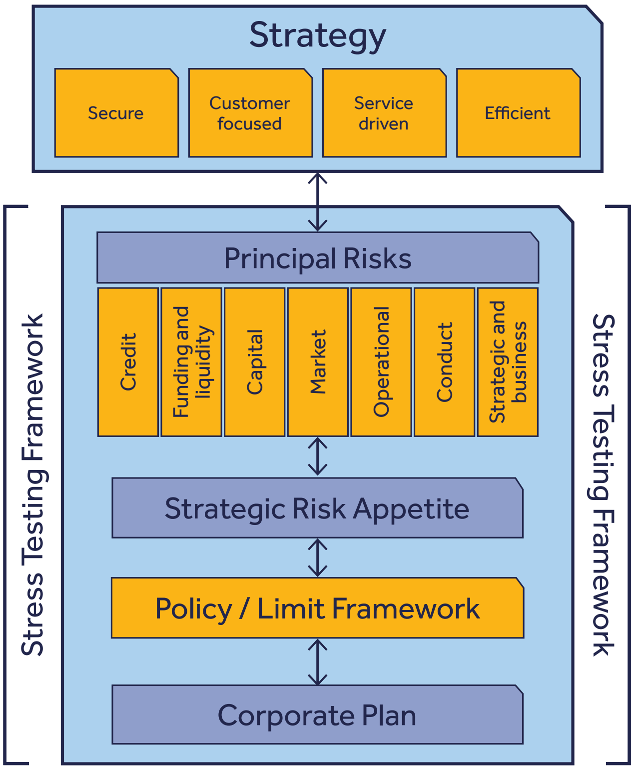
Key performance indicator	What is measured	Performance	2018 update
Service driven (continued)			
% of customer administration processing completed within service standards	The percentage of customer administration completed within agreed service levels.	2018: 93% 2017: 90% 2016: 92% 2015: 93% 2014: N/A	2018 performance reflects high levels of retail savings activity in the first few months. Performance improved consistently throughout the rest of the year, achieving 100% during the last quarter.
Customer satisfaction	The percentage of customers surveyed who described themselves as quite, very or extremely satisfied with the service received from the Society.	2018: 91% 2017: 91% 2016: 92% 2015: 91% 2014: 92%	Customer satisfaction remains 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.	2018: 81% 2017: 80% 2016: 78% 2015: 76% 2014: 76%	Colleague engagement remains high. The Society also achieved a 2* Best Companies rating in 2018.
Efficient			
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.	2018: 44.8% 2017: 43.2% 2016: 43.3% 2015: 36.4% 2014: 33.4%	Costs grew by 4% due to inflation and investment in the business, resulting in an increase in the cost to income ratio as income was unchanged. The Society maintains a strong focus on cost management.
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.	2018: 0.52% 2017: 0.56% 2016: 0.62% 2015: 0.62% 2014: 0.57%	Costs again grew by less than the growth in the balance sheet, reflecting improvements in efficiency. The Society's cost ratios are among the lowest in the building society sector.
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.	2018: 19% 2017: 18% 2016: 15% 2015: 14% 2014: 17%	Colleague turnover is in line with expectations. Operational structures are reviewed on an ongoing basis and turnover reflects the changes made this year.

Principal Risks

Year ended
31 December 2018

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

The Society delivers its vision through a Corporate Strategy, which is built upon four strategic pillars (page 10). Inherent within this strategy are seven principal risk categories. These are: credit; funding and liquidity; capital; market; operational; conduct; and strategic/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 policies approved through the committee process. These set the risk parameters in which to deliver the Corporate Plan, as well as providing appropriate triggers for management response under stressed conditions.



The 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/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 in pages 66 to 70) aim to provide reasonable assurance that the Society understands, manages and monitors the main uncertainties, which the Society faces in achieving its objectives.

During 2018, there was no change in the Society's principal risk categories. The current risk profile associated with its principal risks is summarised below, along with how the Society seeks to mitigate these risks. 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 emerging risks, which could affect the delivery of its strategy (and may cut across principal risk categories), are set out in the Emerging Risks section on pages 20 to 21.

Principal risk	Mitigation	Commentary
Credit risk – retail and commercial		
• 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. • Continuous review of performance versus appetite. • Robust underwriting processes including the use of credit scoring models, affordability stress testing, automated decisioning and suitably qualified underwriters. • Independent appraisal of collateral e.g. valuers. • Dedicated second line Credit Risk Team providing oversight of the Society's lending portfolios. • 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.	• During 2018, the Society was granted regulatory permission to apply the Internal Ratings Based Approach (IRB) to determine capital adequacy for all but legacy lending, reflecting the specific risks associated with the Society's residential mortgage book. • The overall credit quality of the Society's residential portfolio continued to improve, with a reduction in non performing loans. This reflects the good quality of new lending, continued de-leveraging of legacy assets and generally favourable economic conditions in the reporting period. • During 2018, the Society strengthened its underwriting process through the implementation of more extensive risk based decisioning for certain lending segments. • The Society continued to deleverage its euro residential mortgage portfolio, through the sale of its Irish mortgage book. Spanish assets continue to be managed in line with the Society's workout strategy with less than £80 million remaining. • During 2018, the aggregate size of the Society's commercial portfolio reduced further from £72 million to £31 million. Provisions held against these assets are in excess of any negative equity on the portfolio. • The Society implemented IFRS9, with downside economic risks appropriately mitigated by expected credit loss provisions.
Credit risk – wholesale		
• 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 credit 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. • Daily exchange of collateral through clearing and other netting arrangements for derivative exposures.	• During 2018, 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 2018, 90% of the portfolio was invested with UK centric counterparties with an external credit rating of A- or better. • The majority of the Society's derivative portfolio is centrally cleared, which mitigates bilateral counterparty risk. Where this is not possible, derivative exposures are restricted to high quality counterparties and are managed through netting arrangements.

Principal Risks

Year ended
31 December 2018

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 withdrawal 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. • This risk applies to both the Society's retail and wholesale franchises.	• 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, the size of which is based on stressed requirements, as determined through the Board-approved Internal Liquidity Adequacy Assessment Process. • A dedicated first line team monitors the Society's liquidity position daily, with oversight provided by the Risk Function. • 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 liquidity contingency and recovery plans.	• As at the end of 2018, the Society retained a strong liquidity position, which was comfortably above minimum regulatory requirements (LCR of 214%). • The Society's funding profile remains predominately funded by retail savings (78% of share and deposit liabilities) through a strong retail franchise. • The Society also supports funding requirements through its well established wholesale franchise. The Society retains access to capital markets through a diversified investor base. During 2018, the Society utilised this investor base to issue £200 million of Tier 2 debt. • Capital market access is also supported by the Society's strong credit ratings (Fitch: A- and Moody's: A3).
Market risk		
• The risk that market movements adversely impact the Society. • The Society's market risk exposures mainly relate to interest rate risk (including basis and optionality risks) and foreign currency 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 2018, the Society's interest rate risk profile and mitigation approaches have remained broadly similar throughout the period. Therefore, associated risk levels, relative to balance sheet size, have remained generally stable against agreed internal limits and appetite. • The Society's foreign exchange exposures reduced during the year following the closure of its Irish operation. Residual exposures relate to wholesale funding activity and a legacy residential portfolio in Spain. These exposures continue to be managed within Board-approved limits. • The Society continues to evaluate and monitor the impact of macroeconomic and market competition risk, as set out in the emerging risks section, on its interest rate risk strategies and positions.

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.	• 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, 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. • Progression of capital plans with regards to MREL requirements.	• As highlighted on page 30 the Society was granted regulatory permission to apply the IRB Approach to determine capital adequacy during 2018. • The Society maintains strong capital ratios, with capital resources significantly above minimum regulatory requirements. • As at 31 December 2018, the Society's Total Capital Ratio increased to 38.5% (2017:15.0%), driven by the transition to IRB and a £200 million issuance of Tier 2 capital during the year. • The Society's CRR leverage ratio improved marginally during 2018 at 5.1% (2017:5.0%). • The Society also continues to plan for, and respond to, regulatory reforms in respect of capital, including the requirements 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 (including cyber), 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. • Maintenance of an Operational Risk Management Framework, outlining the process for identification, assessment, mitigation and monitoring of operational risks, incident management protocols and reporting operational losses. • Monthly review of performance versus appetite. • Risk control self-assessments, control testing and oversight procedures to validate the control environment. • Maintenance of a programme of IT resilience, cyber defences and business continuity testing. • Risk based approach to mitigate the financial crime risks the Society faces, reflecting the current and emerging financial crime risks within the market. • A People Strategy to ensure that colleagues possess the necessary skills and knowledge to fulfil their role. • Scenario analysis and associated response plans.	• During 2018, the Society developed and implemented an Operational Risk Management Framework, to support the Enterprise Risk Management Framework, to ensure a consistent approach to the identification, assessment, mitigation and monitoring of operational risks. • Further investment in systems across the operational risk universe to enhance the control environment, including IT and cyber capabilities. • Further developments to the Society's approach to business resilience, including third party supplier management, which will continue to be a key focus area for 2019. Action areas are consistent with the intention of the publication of a joint discussion paper by the FCA and PRA on operational resilience. • 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 20.

Principal Risks

Continued

Principal risk	Mitigation	Commentary
Conduct risk		
• The risk that actual or potential customer detriment arises, or may arise, from the way the Society or its third parties, 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 focused business model with limited complexities, relative to larger financial institutions, that could adversely impact customers. • The Society only develops products that meet the needs of its customers, through an embedded 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. • Through the operation of the three lines of defence model, the Risk and Audit Teams oversee and monitor business/colleague activities. • 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 2018, 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 directed significant project and compliance resources in this area, including its preparations for key regulatory reforms, such as the Payment Services Directive 2 (PSD2) and the development of the new mortgage illustration (ESIS). • The Society continues to monitor the external landscape with regard to the activity of claims management companies. • There has been an increased focus on the resilience and conduct of third party providers, which will be progressed further under the Society's operational resilience programme, as referenced in the Emerging Risks section on page 21.

Principal risk	Mitigation	Commentary
Strategic/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, which threatens the sustainability of its business model.	• The strategic planning process sets the business direction and investment activity in the context of the changing regulatory, technological and competitive landscape. • 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 2018, the UK's departure from the EU and the associated uncertainty has continued to provide the backdrop to the Society's operating environment. Whilst the economy has remained relatively resilient to date, the heightened levels of economic and political uncertainty will continue for the foreseeable future. • Significant focus has been given to the positioning of the Society's business model, future plans and investment activity in the context of emerging technologies and customer platforms. • Competition within the Society's core markets remains strong from established players and new entrants. Increased competition continues to reduce margins and underlying profitability. • Customer preference for different mortgage and savings durations continues to influence the term structure of the Society's balance sheet. • The Society continues to maintain an efficient business model with one of the lowest cost to income ratios in the sector at 44.8% (2017:43.2%).

Year ended
31 December 2018

Continued

Emerging risks

Within the context of its principal risk categories, the Society continues to identify, assess and monitor emerging risks through its Enterprise Risk Management Framework, described on page 66. 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 the Board and Board Risk Committee, as part of their strategic and business planning processes. As at the end of 2018, the Society considered the following as its top emerging risks:

Macroeconomic and political risk

Political uncertainty regarding the UK's departure from the EU has continued to provide the backdrop to the Society's operating environment. Economic data released towards the end of 2018 suggested that the heightened level of political uncertainty was acting as a drag on the UK economy.

At the time of writing, finalised transitional arrangements had yet to be agreed by both parties ahead of the March 2019 deadline. As a UK centric business, the Society has limited exposure to the EU. However, the wider impacts of leaving the EU without appropriate arrangements would likely have more material implications for the economy and, more broadly, lending and deposit takers.

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 relatively lower levels of productivity. Crystallisation of these risks could impact the wider economy and the Society.

The Society considers macroeconomic and political risks on a regular basis, under both central and stressed conditions in order to understand and manage the impact on its business model. With regard to Brexit specifically, the Society has considered potential impacts across relevant principal risk categories under a range of outcomes and reflected these in its critical accounting judgements. Alongside this activity, the Society decided to divest its Irish mortgage portfolio during the second half of 2018, which also strengthens its capital position and increases focus on its core UK business.

Competition and business model risk

The profile of the competitive environment highlights a number of evolving risks. The impact of intensified competition from established lenders, as they return to the market after a prolonged period of balance sheet reparation, compounded by the impact of new market entrants and the development of new IT/software solutions to enhance customer offerings, has the potential to threaten the Society's core market proposition through higher customer attrition and lower margins. In particular, the advent and expansion of Open Banking is expected to expedite these trends over the medium term.

The Society carefully considers these risks as part of its strategic/business planning activities, which has set the future path for strategic investment and development to ensure that it is able to adapt accordingly.

Cyber risk

Cyber crime continues to be an ever 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/increase, through ransomware, malware or Distributed Denial of Service (DDoS) attacks.

In response, the Society has developed a Cyber Strategy focused on managing key threats through investment in technology, processes and colleague awareness. This will ensure that appropriate measures are in place to monitor the threat landscape and to protect Society and member assets.

Operational resilience risk
Operational resilience remains a key concern within financial services and for the Society's members. In line with increased regulatory expectations, the Society is enhancing its approach to managing the risk that its systems and processes are unable to deal with increased customer demand or provide resilient services to members.

The Society continues to invest in an IT resilience programme and has developed an operational resilience framework to enhance and align its approach across the resilience disciplines (including IT services, cyber, business continuity and third party management).

An increasingly vital area within operational resilience is third party management. 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.

The Society recognises the importance of rigorous and careful management of its third party relationships and is embedding improved control and oversight arrangements in line within a broader operational resilience framework, both in terms of the on boarding process and ongoing management.

Regulatory change risk
The volume, scale and complexity of regulatory change continues to shape the Society's operating environment. There are currently a significant number of regulatory initiatives in the process of implementation, 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.

Viability Statement

Year ended
31 December 2018

In accordance with the UK Corporate Governance Code, the directors have formally assessed the longer term prospects and viability of the Society, taking into account its current financial position and considering the potential impact of the principal and emerging risks set out on pages 14 to 21.

Longer term prospects

The Society's business model and strategic priorities are set out on pages 8 to 10. These are regularly reviewed by the Board through an annual strategy conference and strategic updates throughout the year. They consider time periods up to five years and beyond.

These reviews considered the strengths of the Society's business model and financial position, including its strong savings franchise and levels of profitability, as well as threats from the emerging risks reported on pages 20 to 21.

Actions identified as part of these reviews are incorporated into the Society's strategy and progressed so that the Society's business model remains relevant.

Assessment period for viability

The directors have considered the viability of the Society over a three year period to 31 December 2021. 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.

Viability assessment activities

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

- a recession causing a reduction in market interest rates resulting in reduced net interest income; and
- a downturn triggered by a sudden increase in inflation and interest rates, which results in increased credit losses.

The directors have also reviewed the Society's 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, including new and emerging regulation where sufficient information is known about future 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.

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

For each of the principal risks identified on pages 14 to 19, stress testing has been performed to understand the ability of the Society to withstand 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. This testing has demonstrated that the Society has the resources, measures and controls in place to manage and withstand such extreme events.

The Society's risk management process, as detailed on pages 66 to 70 includes ongoing monitoring and reporting of emerging risks and scenario analysis enabling further enhancements to the control environment to adapt to these risks.

In particular, the effects on the Society's financial position and performance from a range of potential scenarios resulting from the UK's departure from the EU have been considered within the above corporate planning and stress testing exercises. Of particular note is the impact on impairment loss provisions, the sensitivity of which is illustrated in note 2 of the accounts on page 121. In the range of scenarios considered, while impairment losses could increase significantly, the Society retains sufficient capital to meet its needs.

Conclusion

Based on the above assessments, the directors conclude that:

- The Society's business model remains appropriate and actions have been identified which are intended to enable it to remain relevant as the markets in which it operates evolve;
- The Society maintains an appropriate level of liquidity, sufficient to meet both the normal demands of the business and requirements which might reasonably arise in modelled stressed circumstances. The availability and quality of liquid assets are structured so that funds can reasonably be expected to be available to repay maturing wholesale funds and cover exceptional demand from retail investors;
- The Society has sufficient current capital resources in excess of regulatory requirements and credible plans to meet known future requirements, including MREL, under both central and modelled stressed scenarios; and
- Whilst it is accepted that it is not possible to completely eliminate all risk, the Society 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 2021.

Financial Review

Year ended
31 December 2018

The Society again performed strongly in 2018, with continued balance sheet growth and good levels of profit before tax. Financial performance 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,[1] 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 181 to 184.

Financial performance

The income statement for the year is summarised below:

	2018 £m	2017 £m	Change
Net interest income	218.1	213.2	2%
Fees, commissions and other income	8.5	9.1	(7%)
Fair value gains less losses	(5.7)	(1.3)	(>100%)
Total income	**220.9**	**221.0**	**–**
Management expenses	(98.9)	(95.5)	4%
Impairments on loans and advances to customers	1.2	5.5	(78%)
Other impairments and provisions	0.2	(10.1)	(>100%)
Loss on sale of portfolio of loans and advances to customers	(6.5)	–	–
Profit before tax	**116.9**	**120.9**	**(3%)**
Tax expense	(27.7)	(32.9)	(16%)
Profit after tax	**89.2**	**88.0**	**1%**

Profit before tax reduced by £4.0 million compared with 2017, to £116.9 million. The reduction was primarily driven by a loss of £6.5 million resulting from the sale of the Society's Irish mortgage portfolio (see below). Increased net interest income due to balance sheet growth and lower impairment and provision charges, were offset by an increase in management expenses, as the Society continues to invest in improving the business for members and colleagues, and increased fair value losses.

The Society ceased lending in the Republic of Ireland in 2009. The decision was taken in the year to sell the remaining portfolio in order to strengthen the Society's capital position and focus on its core UK business. The sale completed in November with the transfer of £158.2 million of mortgages and the closure of the Society's operations in Dublin.

Net interest income

The Society's net interest income for the year is summarised below:

	2018 £m	2017 £m	Change
Net interest income	218.1	213.2	2%
Mean total assets	18,937	17,207	10%
	%	%	Change
Net interest margin	1.15	1.24	(0.09)

Net interest income is the Society's primary source of income and it therefore continues to balance the need to offer competitive rates to new and existing borrowers and savers.

Net interest income grew by £4.9 million (2%) during the year to £218.1 million, driven by the increased size of the balance sheet. Net interest margin reduced as margins on new lending continue to fall and the proportion of balances paying SVR continues to reduce, as customers move to new products at the end of their initial product term.

The key features of net interest income during 2018 are:

- There has been a high level of competition in the UK mortgage market in the year, which has driven the tightening of margins on new lending. The Society has partly mitigated this impact with its continued focus on lending to under served segments of the market.
- Following high levels of growth in recent years, 2018 saw increased levels of mortgage customers reach the end of their initial product term. The Society offers competitive products to existing customers when their initial product term ends in order to retain them.
- Competition in the savings market has increased in the year. The Society continues to maintain competitive rates for both existing and new customers. This provides value to members and meets retail funding requirements, paying a minimum of 0.5% on all accounts. On average the Society paid 1.32% (2017: 1.33%) on its savings range, compared to the market average of 0.70%[2] (2017: 0.70%).

1. Financial information refers to the Performance of the Group, as reported on pages 108 to 175.
2. CACI CSDB, Stock, January 2018 – December 2018 latest data available. CACI is an independent company that provides financial benchmarking data and covers 87% of the high street cash savings market.

The trend to lower net interest margin is expected to continue, with competition in the mortgage and savings markets continuing to reduce margins on new lending and encourage product switching.

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 2018, other income reduced slightly to £8.5 million (2017: £9.1 million).

Fair value gains less losses

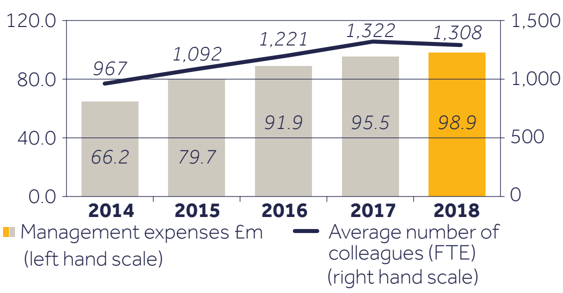
Fair value movements represent changes in the value of certain financial assets and liabilities which are carried at their current market value. The income statement impact is partly mitigated through the use of hedge accounting. Changes in fair value are primarily due to timing differences, which will trend to zero as the asset or liability reaches maturity. Fair value movements in 2018 resulted in a charge of £5.7 million (2017: £1.3 million).

Management expenses

Management expenses for the year are summarised below:

	2018 £m	2017 £m	Change
Colleague costs	61.4	57.9	6%
Other administrative expenses	33.5	34.6	(3%)
Depreciation and amortisation	4.0	3.0	33%
Total management expenses	**98.9**	**95.5**	**4%**
	%	%	Change
Cost to income ratio	44.8	43.2	1.6
Cost to mean asset ratio	0.52	0.56	(0.04)

Management expenses £m and colleague numbers



The Society maintains close control on costs, balancing the need to maintain profitability and grow capital with the need to invest in the business in order to meet the changing needs of members, continue to grow the business and meet the requirements of the highly regulated environment in which it operates.

As a result, management expenses grew by 4% in the year, in line with 2017. This resulted in an increase in the cost to income ratio (since income was unchanged compared to the prior year) while the cost to mean asset ratio improved by four basis points. These ratios remain among the lowest in the building society sector.

In 2018, colleague costs include an additional pension cost following a High Court ruling (in a case which did not involve the Society but which applies across the pension industry) relating to equalising benefits for men and women (see note 24 on page 138). Headcount reduced slightly during 2018. Colleague costs have increased by 6% reflecting the impact of annual inflationary salary increases as well as increased social security and pension costs, including the above charge.

Depreciation and amortisation have increased reflecting the Society's capital investment in technology in recent years. This trend is expected to continue.

Impairments and provisions

The table below summarises the impact of impairments and provision charges (releases) on the Income Statement in the year:

	2018 £m	2017 £m	Change
Residential loans*	2.4	1.4	71%
Commercial loans*	(3.6)	(6.9)	(48%)
Impairments on loans and advances to customers	**(1.2)**	**(5.5)**	**(78%)**
Intangible assets	–	5.6	(100%)
Property, plant and equipment	–	0.9	(100%)
Other provisions	(0.2)	3.6	(>100%)
Other impairments and provisions	**(0.2)**	**10.1**	**(>100%)**
Total impairments and provisions	**(1.4)**	**4.6**	**(>100%)**

*2018 calculated under IFRS 9; 2017 calculated under IAS 39 (see below)

Overall, in 2018 the Society recorded releases of £1.4 million in relation to impairments and provisions, compared to charges of £4.6 million in 2017.

Residential impairment

The Society adopted IFRS 9 from 1 January 2018. This changed the basis for calculating impairment loss provisions from an incurred loss basis to an expected loss basis. Previously provisions were only held for loans where an impairment trigger event had already occurred. Now provisions are held for all loans, based on the probability of each loan defaulting and resulting in a loss, taking into account a range of assumptions about future economic scenarios and an assessment of whether the credit risk of the loan has increased. Impairment loss provisions are therefore recorded earlier in the life cycle of a loan, but there is no change in the actual losses suffered over time. The Society's new accounting policy for residential loan impairment can be found on page 116.

The adoption of IFRS 9 followed a multi-year project, overseen by the Audit Committee, requiring the development of detailed expected credit loss models. These were developed in accordance with the Society's modelling policies and standards and are subject to ongoing monitoring, calibration and review. The adoption of IFRS 9 resulted in an increase in residential impairment loss provisions at the date of adoption of £26.4 million. The full impact of adoption is explained in note 38 to the Accounts on page 170.

The Society's arrears ratio (measured as those loans either in possession or in arrears of more than 1.5% of the balance) has reduced to 0.46% (2017: 0.70%). This improvement is partly due to the sale of the Irish mortgage portfolio, although arrears also reduced from 0.54% to 0.41% on the UK portfolio in 2018.

This reduction in arrears volumes, together with increases in house prices in 2018, caused impairment loss provisions to reduce through the year. However, as noted above, provisions now incorporate assumptions about future economic scenarios. The projected view of key economic variables incorporated into provision models has significantly worsened during the year. At 31 December 2018, impairment loss provisions reflect significant uncertainty relating to the UK's departure from the EU and potential impacts on the UK economy.

Reflecting these worsening economic forecasts has resulted in a residential impairment charge of £2.4 million in 2018 (2017: £1.4 million). Total balance sheet impairment loss provisions against residential mortgages at 31 December 2018 were £27.7 million, as summarised below:

	2018 Closing IFRS 9 £m	2018 Opening IFRS 9 £m	Change	2017 Closing IAS 39 £m	Change
UK residential provisions	20.4	21.1	(3%)	7.7	>100%
UK residential mortgages	15,706	14,687	7%	14,687	7%
UK provision coverage (%)	0.13	0.14	(0.01)	0.05	0.08
Legacy overseas provisions	7.3	29.1	(75%)	16.1	(55%)
Total residential provisions	**27.7**	**50.2**	**(45%)**	**23.8**	**16%**

UK provision coverage has increased compared to the 2017 closing position following the adoption of IFRS 9 and incorporation of an expectation of future losses into the provision. The reduction in provisions and coverage between the opening and closing positions for 2018 under IFRS 9 are driven by the improvement in arrears volumes. Legacy overseas provisions have reduced due to the sale of the Irish mortgage portfolio.

Commercial impairment

The adoption of IFRS 9 also changed the basis of calculation for commercial impairment loss provisions, although this had no material impact on the level of provisions at 1 January 2018 compared to the previous IAS 39 basis.

The Society continues to successfully manage down its legacy commercial lending portfolio, including the redemption of all loans in arrears or possession. Exposure to commercial loans fell to £30.8 million at 31 December 2018 (2017: £71.6 million). Realised losses were lower than anticipated and consequently a credit of £3.6 million (2017: £6.9 million) has been recognised in the year.

Provision coverage has reduced with the improvement in credit quality of the portfolio. At the end of 2018, the Society has balance sheet impairment provisions against commercial mortgages of £4.0 million (2017: £17.2 million).

Other provisions

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. The levy payable by the Society to FSCS reduced significantly in 2018, after repayment of the FSCS's loan from HM Treasury following asset sales by Bradford and Bingley.

This resulted in a £0.3 million release of provisions held at the start of the year. A small provision is retained in relation to the levy payable in early 2019.

The Society also retains provisions for customer redress payments, including in respect of mortgage payment protection insurance, reflecting the expected level and value of claims and the cost of investigating them. This takes into account the claims deadline in 2019 and the Plevin ruling. No additional amounts were required to be provided for during 2018.

Taxation

The income tax expense of £27.7 million (2017: £32.9 million) represents 23.7% (2017: 27.2%) of profit before tax. The Society pays UK corporation tax at the prevailing rate of 19% for 2018 (2017: 19.25%) and also pays the 8% surcharge on banking profits over a £25 million threshold introduced in 2016. The reduction in the effective tax rate noted above is due to adjustments in respect of prior years and deferred tax.

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.

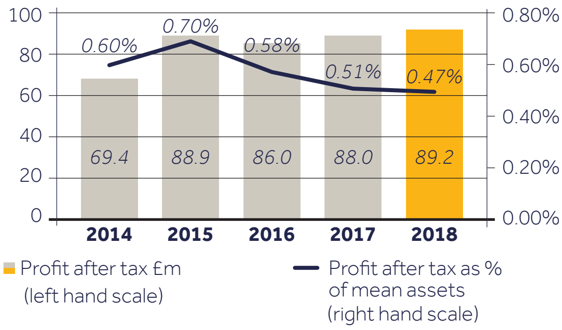
A tax policy has been agreed by the Audit Committee which provides a framework for the operation, planning and oversight of tax and tax risk to ensure compliance with relevant legislation. The Society's tax strategy is published on its website. The Society is committed to transparency in the reporting of its tax affairs and is proud to have been awarded the Fair Tax Mark in December 2018. More information on this can be found on page 42.

Profit after tax

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

The Society continues to generate a stable level of profit, with profit after tax for 2018 increasing by 1% over 2017 to £89.2 million. Profit after tax as a percentage of mean assets reduced slightly due to the lower net interest margin.

Profit after tax £m



Financial position

Total assets increased by 5%, to £19.4 billion. The rate of growth was lower than in previous years as new lending was scaled back. Mortgage redemptions also increased following lending growth in earlier years, resulting in a greater number of customers reaching the end of their initial product term in 2018.

	2018 £m	2017 £m	Change
Residential loans	15,805	14,932	6%
Commercial loans	31	72	(57%)
Other loans	232	250	(7%)
Impairment provision	(34)	(44)	(23%)
Loans and advances to customers	**16,034**	**15,210**	**5%**
Liquid assets	2,827	2,730	4%
Derivative financial instruments	273	259	5%
Fixed and other assets	256	285	(10%)
Total assets	**19,390**	**18,484**	**5%**

Residential mortgage asset quality	**%**	**%**	**Change**
Proportion of mortgages in arrears	0.46	0.70	(0.24)
Balance-weighted average indexed LTV of mortgage book	54.6	55.6	(1.0)
Balance-weighted average LTV of new lending	61.5	63.9	(2.4)

Year ended
31 December 2018

Continued

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. During the year, the Society sold its portfolio of mortgages in the Republic of Ireland. It retains balances in Spain and Gibraltar, which make up less than 0.5% of total loan balances.

The Society does not make new commercial loans and has actively managed down its legacy commercial loan portfolio. 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 new lending during the year was £3.8 billion (2017: £4.1 billion), with the reduction on last year primarily as a result of targeting lower growth due to increased competition in the mortgage market. Despite this, the Society's share of new mortgage lending remained above its natural market share at 1.4% (2017: 1.6%) compared to 1.1% (2017: 1.1%)[3].

The Society continues to focus on borrowers in specific segments, such as buy to let or shared ownership, utilising its funding capacity and strong capital position to support a wide range of borrowers. In total, lending to these segments represented almost 60% of new lending. This focus on higher margin lending supports the Society's profitability and strengthens its position for existing and future members, while remaining within risk appetite.

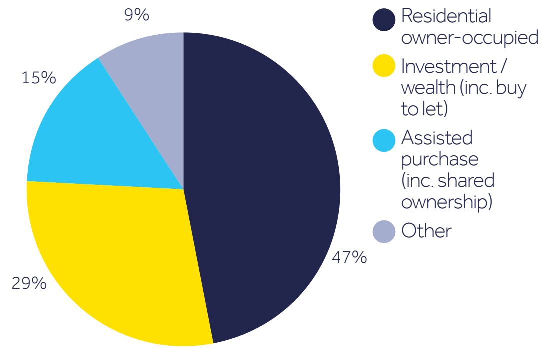
The Society maintains a conservative lending policy, which is reflected in the distribution of loan to value (LTV) ratios. The average LTV of new lending in 2018 was 61.5% (2017: 63.9%).

Net lending, excluding the sale of the Irish mortgage portfolio, was £1.0 billion in 2018, £0.8 billion lower than the previous year. Strong growth in mortgage balances in recent years meant that an increase in redemptions was expected as more customers reached the end of their initial product term.

UK residential mortgage balances

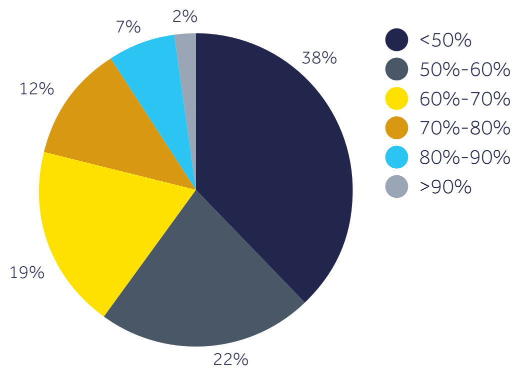
The mix of new lending in recent years means residential owner-occupied balances now make up less than half of UK residential mortgage balances, with buy to let increasing from 25% of the book at 31 December 2017 to 29%.

2018 UK residential mortgage balances by type



At 31 December 2018, the weighted average indexed LTV of the portfolio as a whole was 55% (2017: 56%). The distribution of the LTV profile of the portfolio is shown below.

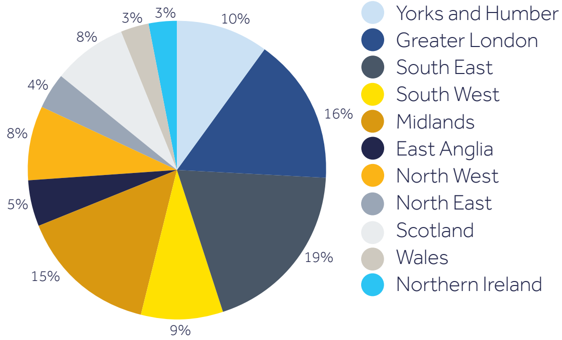
2018 UK residential mortgage balances by indexed LTV



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

3. 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

2018 UK residential mortgage balances by region



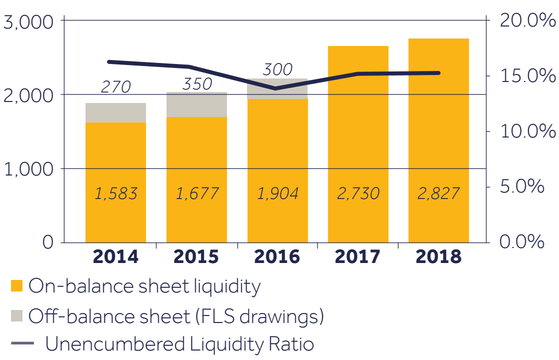
Liquid assets

Liquidity ratios	2018 %	2017 %	Change
Liquidity Coverage Ratio (LCR)	214	198	16
Net Stable Funding Ratio (NSFR)	145	135	10
Total unencumbered liquidity	15.1	14.8	0.3

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

Liquidity £m / %

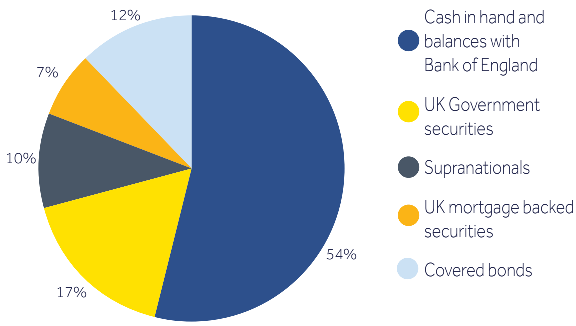


Total liquid assets at the end of 2018 were £2.8 billion, compared to £2.7 billion at the end of 2017. The level of liquidity can vary due to the timing of funding receipts compared to mortgage completions and other refinancing obligations.

Liquidity included £2.6 billion of High Quality Liquid Assets (2017: £2.5 billion), which are either in cash or are readily realisable as cash when required. 100% of assets are rated 'A' or above (2017: 99%).

The Society's mix of liquid assets at 31 December 2018 is shown below.

2018 liquidity portfolio



The Prudential Regulation Authority (PRA) monitors liquidity under the Capital Requirements Directive IV (CRD IV) framework. The Society's LCR is 214% (2017: 198%), in excess of the regulatory minimum of 100%. The NSFR is currently calculated based on the Society's interpretation of expected requirements as 145% (2017: 135%).

The Society's unencumbered liquidity ratio, which represents liquid assets as a proportion of shares, deposits and liabilities, was 15.1% at 31 December 2018 (2017: 14.8%).

Liabilities

A summary of the Society's liabilities is below:

	2018 £m	2017 £m	Change
Shares	13,910	13,072	6%
Wholesale funding	3,871	4,061	(5%)
Derivative financial instruments	133	162	(18%)
Other liabilities	226	205	10%
Subscribed capital	224	25	100%
Total liabilities	**18,364**	**17,525**	**5%**
Equity attributable to members	1,026	959	7%
Total liabilities and equity	**19,390**	**18,484**	**5%**

Key ratios	%	%	Change
Wholesale funding ratio	20.3	22.2	(1.9)

Year ended
31 December 2018

Continued

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 lending growth aspirations.

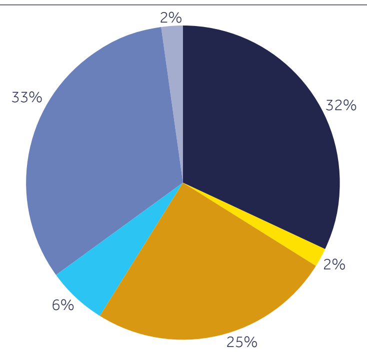
Shares (retail savings)
The Society continues to offer competitive savings rates to both existing and new members with a simple product proposition. Savings balances increased by £0.8 billion, representing growth of 6% to a record £13.9 billion (2017: £13.1 billion).

Wholesale funding
The Society continues to access wholesale markets to complement its retail savings activity. The Society aims to maintain wholesale balances at approximately one fifth of total funding, although as it seeks to take advantage of favourable funding conditions the proportion of wholesale funds can increase above this level. Total wholesale funds at 31 December 2018 were £3.9 billion (2017: £4.1 billion), representing 20.3% of total funding.

During the year, the Society drew down a further £375 million from the Term Funding Scheme (TFS) before that scheme closed to drawdowns at the end of February. This brought total drawings under the TFS to £1.2 billion. TFS drawings are repayable four years from the date of drawdown. Two covered bonds were repaid during 2018 with a value of £550 million.

The mix of the Society's wholesale funding portfolio at 31 December 2018 is shown below:

2018 wholesale funding portfolio



The Society maintains strong credit ratings from two key agencies reflecting its strong capital position, good profitability and strong funding position.

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

Subscribed capital
In April 2018, £200 million of Tier 2 capital was successfully issued as part of plans to meet the expected future Minimum Requirement for Own Funds and Eligible Liabilities (MREL) for the Society.

Capital
The Society maintained its strong capital position throughout the year, with all capital ratios significantly in excess of the regulatory minimums.

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

Capital resources	2018 £m	2017 £m	Change
Total equity attributable to members	1,026	959	7%
Less pension surplus, intangible assets and other regulatory adjustments	(29)	(7)	>100%
Common Equity Tier 1 (CET1) capital	997	952	5%
Additional Tier 1 capital	10	12	(17%)
Total Tier 1 capital	1,007	964	4%
Tier 2 capital	218	24	>100%
Total regulatory capital resources	1,225	988	24%
Risk weighted assets (RWAs)	3,183	6,577	(51%)
CRD IV capital ratios	**%**	**%**	**Change**
CET1 ratio	31.3	14.5	16.8
Total capital ratio	38.5	15.0	23.5
CRR leverage ratio	5.1	5.0	0.1
UK leverage ratio	5.5	5.5	–

In June 2018, the Prudential Regulation Authority (PRA) granted the Society an Internal Ratings Based (IRB) permission in relation to its measurement of capital. This allows the Society to calculate its capital requirements for most of the residential mortgage book using internally determined risk parameters that reflect the specific risks of the book. As a result, the Society's risk weighted assets – a key driver in the calculation of how much capital is required to be held – have reduced and capital ratios have increased.

CET1 capital resources have increased by £45.3 million in the year, mainly as a result of the strong profit performance, partly offset by the impact of the adoption of IFRS 9 and changes in measurement following the move to the IRB basis.

The Society has utilised available transitional arrangements in relation to the impact of adopting IFRS 9 on regulatory capital and the figures above reflect those arrangements. Had the transitional arrangements not been adopted, the CET1 ratio would have been four basis points lower and the CRR leverage ratio would be unchanged at 31 December 2018.

Balance sheet growth is planned and managed to ensure good use of the Society's resources, while maintaining a strong capital position. The Society's future capital and funding plans incorporate requirements for MREL and other expected changes to the capital regime for banks and building societies. Consequently, the Society remains well placed to meet regulatory capital requirements as they continue to evolve.

Changes to accounting standards

As previously outlined, the Society adopted IFRS 9 – Financial Instruments from 1 January 2018 although, as permitted under the standard, it continues to apply the hedge accounting requirements of IAS 39. Further details can be found in note 38 to the accounts, on page 170.

The Society will adopt IFRS 16 – Leases from 1 January 2019. This means that assets the Society leases will be recognised on the balance sheet, as will a corresponding liability for the future lease payments. On adoption, this is expected to increase both assets and liabilities by approximately £12.3 million.

Financial outlook

2018 has been another successful year for the Society as it generated strong profits and grew the balance sheet in a measured way, maintaining financial strength.

At the end of the year, the outlook for the UK economy is particularly uncertain, with the basis for and impact of leaving the EU on 29 March 2019 unclear. This uncertainty has been reflected in the calculation of impairment loss provisions. If the outcome is worse than expected, this may result in an increase in impairment charges in future years. The potential impacts are illustrated in note 2 to the financial statements on page 121.

It is expected that competition in the mortgage and savings markets will continue to intensify, both from existing participants and new technology-driven entrants. This will drive continued downward pressure on margins. The Society will continue to look to mitigate this impact by targeting specific segments of the market which are less well served by the wider market. The Society also continues to invest in technology to remain competitive and meet the needs of existing and potential members.

The Society retains a strong franchise in mortgage lending and retail savings which will help with future growth. Strong efficiency ratios and conservative risk appetite are expected to support continuing strong profitability underpinning the financial security that is so important to members' confidence.

Non financial information statement

The Society has complied with the requirements of S414CB of the Companies Act 2006 by including certain non financial information within the Strategic Report. The required information can be found as follows:

The Society's business model is described on page 8 and key indicators of performance are on pages 11 to 13.

The Society has set targets to reduce its impact on the environment within its corporate responsibility targets. These are included in more detail on pages 34 to 43.

The Society's Colleague Policy is designed to ensure the fair, transparent and consistent treatment of colleagues in accordance with legislative and regulatory requirements. Further information on the Society's strategy in relation to colleagues is detailed on pages 32 to 33.

The Society has a zero tolerance approach to bribery and corruption and upholds ethical behaviours in its business activities at all times. All colleagues undertake regular mandatory training on the required standards as detailed in the Prevention of Financial Crime Policy.

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

Colleagues

Year ended
31 December 2018

Providing a positive colleague experience is essential to creating an environment where all our people understand how their contribution delivers our mission and values. It is through our highly engaged colleagues that we deliver a great level of service to our members.

In 2018, we continued embedding our people strategy and we focused on three commitments, to further drive our people experience. These are:

Career – all colleagues have regular and focused time with their managers throughout the year. Their contribution, progress, personal development and career aspirations are discussed, reviewed and evaluated, supporting them in their current roles and helping them prepare for their next role.

Curiosity – colleagues are supported with keeping their skills up to date, with 5% of working time made available for training, learning and development.

Communication – positive, regular and informative communication is critical to ensure colleagues have the information they need to do their jobs and remain engaged with the Society and our members. Manager briefings, a regular newsletter, a colleague app, monthly CEO video blogs and an intranet are just some of the ways teams are kept engaged and informed. Our executive team shares our plans in detail at annual roadshows attended by all colleagues across the country.

Feedback is a valuable part of our engagement approach. Through surveys, team meetings and other opportunities, we listen to views on a range of matters, including how we might improve things for members. Our suggestion scheme 'Let's Be Smart', enables everyone to contribute their ideas. We use these ideas to make service and process improvements. The Society recognises our colleagues' achievements, promoting excellence and supporting demonstration of our values in the workplace.

The Leeds Building Society Colleague Association provides a further route for us to hear views. In 2019, Lynn McManus, non executive director, will also assume responsibility for representing colleagues' views to the Board.

In 2018, the progress we have made resulted in our highest ever engagement score of 81% (2017: 80%), with 95% of colleagues responding to our Your Voice survey. We also achieved a 2* Best Companies accreditation (2017: 1*), defined as '**an outstanding commitment to workplace engagement**'.

In August 2018, we were re-accredited with the Investors in People (IiP) Standard, reflecting the Society's work on developing better leadership and a better workplace.

Developing our talent

Our strong learning culture helps colleagues to develop their skills and, in turn, their careers. In 2018, we delivered 24,450 hours of face to face learning, 72 secondment opportunities allowed for the broadening of business knowledge and experience and we supported 156 colleagues in obtaining external qualifications. Learning is delivered through a variety of methods, including face to face and online. In 2019, we will extend this further when we launch our mobile learning app.

Identifying essential skills aligned to our future skills requirements helps us to determine how we recruit, select and develop. In 2018, we delivered a new competency framework, reflecting our longer term aspirations and expectations, and helping to focus effort in providing tailored training, support and development solutions.

Diversity and inclusion

In 2017, we launched our diversity and inclusion strategy. Our single statement ambition is to 'have an inclusive culture which enables colleagues with a diverse range of skills, experiences, backgrounds and opinions to flourish without barriers'. We remain committed to these aims and have made significant progress.

In 2018, we focused on two key priorities: gender diversity and mental health awareness, with colleague-led forums supporting each initiative.

On gender diversity, our aim is to improve the numbers of women who are able to take up positions at more senior levels, balancing gender representation. We made clear progress on our gender diversity agenda, including:

- We support the Women Ahead mentoring scheme, with 20 women participating in the scheme and receiving mentoring from senior leaders in other organisations and have provided mentoring for 20 women in other organisations.
- We are a signatory to HM Treasury's Women in Finance Charter. On publication of our progress against our gender diversity in September 2018, we were pleased to report that we had reached our target for gender diversity in our senior leadership team (33%) and are making progress to achievement of our target for the Board.

Our mental health and wellbeing approach is focused on providing awareness and support for colleagues. We have successfully:

- Trained 35 mental health first aiders, providing support to everyone across our business.
- Provided training for managers and colleagues in understanding and supporting mental health in the workplace and trained 26 people from other building societies as mental health first aiders.
- Provided online support, with access to varied and useful information, in collaboration with our charity partners Samaritans.

We have Disability Confident Employer status, awarded for demonstrating we have the right policies and practices in place for supporting potential future colleagues with disabilities into the workplace, retaining and developing them.

Our progress on diversity and inclusion agenda has been recognised externally:

- In 2018, we received Leaders in Diversity accreditation from the National Centre for Diversity (NCfD), being the first financial services organisation to achieve this.
- In January 2019, NCfD further recognised our work in equality, diversity and inclusion by presenting us with two national awards: Large Business of the Year and Financial Services Company of the Year.

Information on the composition of our workforce at the end of 2018, is shown below:

		2018 Females	**2018 Males**	2017 Females	2017 Males
Colleagues	Number	827	468	811	492
	Percentage	64%	36%	62%	38%
Managers	Number	31	62	31	56
	Percentage	33%	67%	36%	64%
Directors*	Number	3	10	3	10
	Percentage	23%	77%	23%	77%

* number includes executive and non executive directors

At the end of 2018, we have 115 colleagues from ethnic minorities, comprising 8% of the workforce (2017: 8%).

In 2019, our diversity and inclusion priorities will extend to focus on ethnicity, to ensure the equal access of opportunities to all, regardless of identity, background or circumstance. All our colleagues will receive diversity and inclusion training during the year.

Reward

Our fair reward principles ensure we offer fair pay, which is benchmarked externally and is designed to ensure we can attract and retain the skills and experience we need. We are committed to paying the Living Wage and all colleagues are eligible to participate in a bonus scheme, which is linked to the Society's financial success, improving our customer experience and individual performance.

Corporate Responsibility

Year ended
31 December 2018

Doing business the right way

The Society was set up over 140 years ago to help people to save and have the home they want. We remain true to this purpose today and now have over 800,000 members, 1,400 colleagues and a network of 55 branches across the UK.

As a member-owned building society, we have a responsibility to do what's right for our members, colleagues and communities. That's why in 2017 we set twelve Corporate Responsibility targets to reach by the end of 2020, along with a commitment to report our progress annually.

To date, we have achieved three of our targets earlier than planned, including reducing our carbon emissions by almost 1.2 million kg CO_2e[1] (the equivalent of taking 560 average sized cars off the road for a year), growing our TalkingPoint membership to over 2,900 members and delivering in excess of 10,500 volunteering hours into our communities.

Our progress has been recognised by a range of external organisations. In 2018, the Society was awarded Leaders in Diversity status by the National Centre for Diversity, achieved the Fair Tax Mark (demonstrating our commitment to tax transparency) and continues to retain the Carbon Trust Standard for Carbon.

Our framework

Our Corporate Responsibility framework sets 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 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.

Highlights

- We were the first national high street lender to launch a Retirement Interest Only product to support borrowers aged between 55 and 80.
- Our shared ownership proposition has been enhanced to support more people to get a foot onto the housing ladder.
- We were awarded a Gold Ribbon from Fairer Finance for our savings accounts.
- Together with our colleagues and members, we have raised over £371,000 for charities and good causes.
- We increased our volunteering target from 8,000 to 14,000 volunteering hours by the end of 2020.
- 35 Society colleagues have trained as mental health first aiders to support other colleagues who may be struggling to cope.
- We launched the parkrun Community Reward Scheme, helping to improve local parks across the UK.
- We secured Internal Ratings Based (IRB) permission, which reflects how we measure, manage and control risk effectively.

1. Our carbon footprint is measured in tonnes of carbon dioxide equivalent. This is a standard methodology and allows different greenhouse gas emissions to be compared on a like for like basis relative to one unit of CO_2.

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 **60%** of the way towards reaching our target having supported over **134,000** people to save for their future since 2017.

Target 2

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

PROGRESS: ON TRACK

We're **54%** of the way towards reaching our target having supported **94,000** people to have the home they want since 2017.

Target 3

Help **30,000** **first time buyers** into a home of their own

PROGRESS: ON TRACK

We're **83%** of the way towards reaching our target having supported almost **25,000** first time buyers to get onto the housing ladder since 2017.

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 **80%** in 2017 to **81%** in 2018.

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 CO_2e**

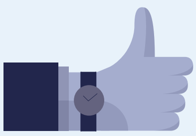
PROGRESS: ACHIEVED

Our carbon emissions decreased by almost **1.2 million kg CO_2e** between 2016 and 2018 (see page 40 for full information)[2].

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, has increased to **91%** in 2018.

Target 8

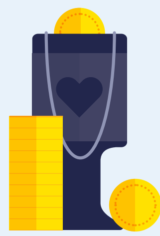
Provide **14,000** colleague **volunteering** hours in the community

PROGRESS: INCREASED TARGET

Our target has increased from **8,000** to **14,000** volunteering hours. We're **75%** of the way towards reaching our target having invested over **10,500** hours into communities since 2017.

Target 9

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



PROGRESS: ON TRACK

We're **58%** of the way towards reaching our target having donated over **£700,000** to charities and good causes.

Sustainable & Responsible

Target 10

Maintain financial strength and ability to grow through maintaining Total Capital Ratio in excess of 20%

PROGRESS: ON TRACK

This target was recalibrated in 2018 to use a Total Capital Ratio instead of CET1 capital (further details on pages 42 to 43). The Society's Total Capital Ratio was 38.5% in 2018.

Target 11

Achieve better than the industry average for FOS upheld complaints

PROGRESS: ON TRACK

On average **19%** of complaints were upheld in favour of our customers between 1 January to 30 June 2018. The average for all financial businesses during this period was **30%**.[3]

Target 12

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

PROGRESS: ACHIEVED

Almost **3,000** of our members are actively engaged on TalkingPoint giving their views and helping to shape our decisions.

2. 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 using DEFRA emission factors for the relevant years. 3. We are using the latest publicly available data that was available from the Financial Ombudsman Service.

Corporate Responsibility

Continued

Actions taken

Money & Homes

The Society's purpose is to help people to save and have the home they want. Our products are the principal way we deliver against this purpose and how we contribute to the society we are part of. In 2018, we made good progress against our three targets in this area, supporting over 63,000 people to save for the future, almost 44,000 people to have the home they want and nearly 12,000 first time buyers.

Supporting savers

Savings provide an important safety net should the unexpected happen, yet according to the Money Charity[4] around 9.45 million (35%) households in the UK have no savings. As part of our approach to corporate responsibility, the Society continues to take steps to make saving as attractive as possible and to support people to reach their goals.

This starts with a competitive rate; the Society paid an average of 1.32% to its savers compared to the market average of 0.70%[5] in 2018. However, we know that access to funds can be just as important. This is why the Society offers a range of accounts to allow customers to withdraw as flexibly as their needs require.

To develop savings habits from an early age, the Society offers a range of children's accounts, with many of our instant access accounts requiring a minimum £1 opening balance, making them accessible to a wide range of customers, including those who are limited by how much they can save.

Later life borrowing

Based on estimates from the Office for National Statistics, by 2045, almost 25% of the population will be over 65 years of age (up from 15% in 2015[6]). Older age lending is a growing social issue and, as a responsible lender, we have carefully considered what support we need to provide to help people either buy or stay in their home in their later years.

Following extensive research, the Society became the first national high street lender to launch a Retirement Interest Only product for older borrowers. We will now lend to borrowers aged between 55 and 80. The capital (i.e. the sum that was borrowed) is paid back at a specified life event. This can include the sale of the property or moving into residential care.

Affordable housing

Access to housing remains a challenge for many people across the UK. This is particularly important for first time buyers. According to the Resolution Foundation, today's thirty year olds are only half as likely to own their home as the baby boomers[7]. This is why the Society is committed to removing barriers to make housing more accessible to more people.

In order to support first time buyers, the Society offers high loan to value (LTV) mortgages of up to 95%, which helps to reduce deposit requirements for first time buyers. We also support a range of affordable housing initiatives, including Help to Buy and schemes such as rent to buy and Right to Buy.

The Society has supported shared ownership for over 30 years and in 2018 lent £345 million through the scheme, which involves a customer buying part of a property and renting the remaining part. In 2018, we announced a further increase in support for affordable housing by increasing the number of properties we can lend to on a housing site, opening more doors for people who may be unable to access a traditional mortgage.

Equally, the rental market remains an important part of the housing mix in the UK and the Society is supporting this through its buy to let lending strategy. We have a responsibility to encourage landlords to do the right thing, which is why our buy to let mortgage lending terms continue to allow landlords to rent homes to those in receipt of housing benefits.

4. Source: https://themoneycharity.org.uk/media/October-2017-Money-Statistics1.pdf
5. CACI CSDB, Stock, January 2018 – December 2018, latest data available. CACI is an independent company that provides financial benchmarking data and covers 87% of the high street cash savings market.
6. https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/articles/overviewoftheukpopulation/mar2017
7. Source: https://www.resolutionfoundation.org/publications/home-affront-housing-across-the-generations/

Developing products

The Society's product governance ensures that products are developed, launched and managed in a structured way that fully considers the needs of our members alongside regulatory requirements. We take time to identify potential impacts on those in vulnerable circumstances and, once launched, our products are subject to periodical reviews. Lending to customers is always based on strict affordability criteria.

Members & Communities

Over the last year we have continued to focus on putting the customer at the heart of our decision making, making changes to speed up processes and making our products as straightforward as possible. Through our partnerships with Samaritans and parkrun, we have worked hard to maximise the difference we make in communities, raising funds to support those who are struggling to cope and improving open spaces across the country.

Improving customer experience

The Society's customer experience programme focuses on the ways we continue to meet the needs of our customers. One of the improvements we made in 2018 was to send out mortgage maturity letters 42 days before a product matures, instead of 28 days. This now gives our members more time to consider their options.

In 2018, we were awarded a Gold Ribbon for our savings accounts from Fairer Finance, an independent organisation focused on creating a fairer financial services market for consumers and the businesses that serve them. We performed better for customer experience than 80% of other providers in the market. The Gold Ribbon demonstrates our continued focus on customer satisfaction, handling complaints, explaining our savings accounts clearly and making it easier to apply.

Samaritans

In 2018, the Society started a two year charity partnership with Samaritans. Our ambition: to raise £250,000 by March 2020.

Every six seconds someone contacts Samaritans. Their volunteers respond to around 5.7 million calls for help each year. In a connected and technologically-changing world, people are choosing to talk to its volunteers in different ways. The number of people contacting Samaritans by text and email increased by more than a quarter – from around 683,000 in 2016 to 868,000 in 2017, putting greater pressures on their service.

The funds the Society raises will pay for new equipment, including laptops, headsets and phones for Samaritans branches. This kit will enable their volunteers to move more easily between communication channels and react more quickly to the demand for round the clock emotional support services for anyone who is struggling.

In the first nine months of the partnership, we've raised over £145,000 towards our fundraising target. Our members and colleagues have contributed in a number of ways. This has ranged from selling Christmas cards in branch through to 100 of our colleagues taking part in 'Rough Runner' (an endurance challenge).

The Society introduced 100% matched funding to further support the efforts of its colleagues' fundraising. For every £1 a colleague raised through sponsored activities for Samaritans, the Society matched it by another £1 in 2018.

parkrun

parkrun UK is a not for profit organisation that supports more than 570 communities across the country to deliver free, timed 5k events every Saturday morning. parkruns are open to walkers and runners of all ages and abilities and more than 1.8 million people across the UK have taken part.

Year ended
31 December 2018

Continued

Similar to Leeds Building Society, parkrun also recognises the importance of community cohesion and aims to positively contribute to the communities in which they are based. As a way of further supporting parkrun communities, and to help upgrade some parkrun environments, the Society launched the Community Reward Scheme in May 2018.

The scheme is all about recognising the significant role that parkrun plays in helping people engage with their local communities and exists to provide funding to projects that help and improve local parks.

Projects can be recommended by any UK parkrunner and in 2018, the Community Reward Scheme donated over £22,000 to 10 different parkruns. Projects funded to date include play area development, path improvements, storage facilities and gardens.

Phil Hodgson from Cross Flatts parkrun said of their project: "Being able to provide a permanent shelter allows the running community to give something back to the park for everyone to benefit from. It also allows us to demonstrate parkrun's commitment to the community we all share."

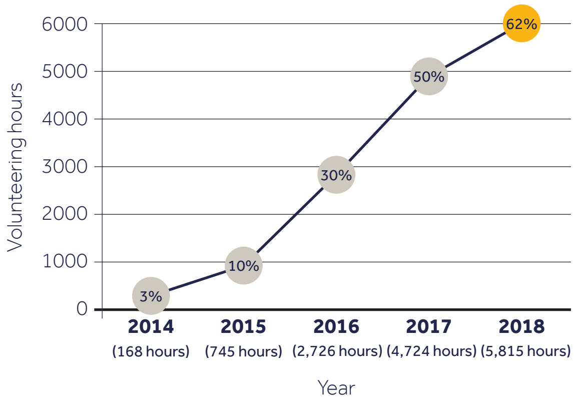
Volunteering

Volunteering is an important way in which Society colleagues can contribute to their local communities. Every colleague is entitled to seven hours of paid leave each year and they are encouraged to use it to support a good cause of their choice, either as an individual or part of a team.

The scheme continues to be increasingly popular and 2018 saw the highest participation rate to date, with 62% of colleagues choosing to use their volunteering time. Collectively we invested over 5,800 hours in projects across the UK.

To give a further boost to our communities, we introduced an additional seven hours for colleagues to volunteer with the Society's national partnerships: Samaritans and parkrun.

Colleague volunteering



Due to the increase in colleague volunteering and the introduction of an additional seven hours, the Society has met its 2020 volunteering target early. The Board of Directors therefore agreed to increase the target to 14,000 hours, further stretching our ambition within local communities.

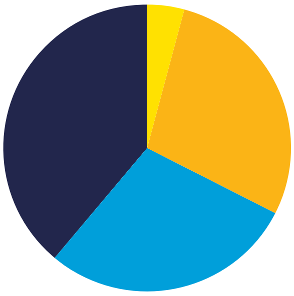
The Society, its members and colleagues invested £518,500 in communities in 2018. This includes cash donations of £371,000 and a time equivalent value of £147,500.

Inputs – where our giving comes from

- Society donations – £175,000
- Member donations – £116,000
- Value of volunteering time* – £147,500
- Colleague fundraising – £80,000

*Value of time includes colleague volunteering and community based colleague secondments.

Outputs – where our giving goes



- Community Rewards Scheme – £22,250
- Samaritans – £145,750
- Leeds Building Society Foundation – £147,750
- Other charities & local causes – £202,750

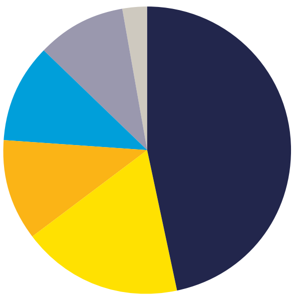
Leeds Building Society
Foundation

The Leeds Building Society Foundation makes donations to UK charities which are improving the lives of people who are disadvantaged or in vulnerable circumstances.

Funded by the Society and its members, the Foundation has donated more than £1.8 million to over 2,600 local projects and good causes across the UK since it was founded in 1999. It mainly supports charities to purchase equipment or materials which directly support their beneficiaries. Funding decisions are made by a Board of Trustees, including experts from the charity sector and colleagues of the Society. In 2018, two new Trustees were recruited to further diversify the decision making expertise.

In 2018, more than £130,000 was donated to 147 causes, supporting a variety of causes, including helping those with disabilities, people affected by homelessness and those with serious health issues.

Funding by theme



- Disability – £62,500
- Disadvantage – £24,000
- Inclusion – £15,250
- Health – £14,750
- Homelessness – £13,500
- Other – £3,500

People & Places

In 2018, the Society achieved 2* Best Companies status. This underlines our commitment to offer a great working environment for all our colleagues. We provide colleagues with a range of benefits, including a colleague assistance programme and flexible working arrangements to support wellbeing.

As the UK's fifth largest building society with over 1,400 colleagues, we also have a responsibility to manage our own carbon emissions. Since achieving the Carbon Trust Standard in 2017, we have continued to take action and this year we have reported our direct and indirect carbon footprint (known as scope 1 and scope 2 emissions) across our office and branch sites.

Supporting our colleagues to stay well

The Society is committed to being a great place to work and providing the right conditions for our colleagues to thrive in their roles. The wellbeing of our colleagues is vital, if we are to attract and retain talent and be able to serve the needs of our members.

Our health and safety working group is responsible for ensuring the Society's policies, procedures and working practices regarding health and safety meet legal and compliance obligations. The Society has a flexible working policy and 48% of our colleagues now work non standard hours. A colleague assistance programme offers 24/7 support for colleagues and their families including access to confidential counselling.

Recognising that one in four people in the UK are affected by mental health conditions – and in line with our partnership with Samaritans – mental health awareness and support has been a particular focus in 2018.

We have focused on improving mental health awareness, encouraging open conversations about mental health and making information, tools and training accessible to colleagues. The Society has aligned its mental health programme with the 'Core Standard Recommendations' from the Thriving at Work Government Report (October 2017) and remains committed to reviewing the 'enhanced recommendations' in 2019. The launch of a colleague-led, mental health forum has supported the changes that have been made.

The Society has trained 35 Mental Health First Aiders since May 2018. These colleagues are on hand to provide early intervention support, guidance and signposting to others who may be experiencing a mental health concern.

Equal weight has been placed on upskilling colleagues to better recognise mental health issues within themselves. Training for leaders focuses on developing the skills and confidence to discuss mental health at work and to spot signs when mental wellbeing may be decreasing for someone. A total of 159 people have been trained on mental health awareness in 2018, which equates to over 10% of the colleague population.

In December 2018, we launched 'Wellbeing in the City', a tool developed by Samaritans. This is an online learning tool that gives colleagues the skills to intervene when someone is struggling. The Society is one of the first businesses in the UK to host this on its own learning and development platform.

Recognising that mental health is an issue that affects the financial services sector as a whole, the Society trained Mental Health First Aiders at 14 other Building Societies free of charge.

Promoting a diverse and inclusive culture

When developing our approach to corporate responsibility, our stakeholders identified diversity and inclusion as one of the most important issues for the Society to get right. Given our network of branches across the UK, it is vital that we represent the communities in which we operate.

The Society launched its diversity and inclusion strategy in 2017, with the ambition to have an inclusive culture, which enables colleagues with a diverse range of skills, experiences, backgrounds and opinions to flourish, without barriers.

In 2018, the Society achieved 'Leaders in Diversity' status from the National Centre for Diversity. This recognises the practices we have implemented and the cultural shift that has taken place in the Society.

The Society is a signatory to HM Treasury's Women in Finance Charter, which includes an aspiration to achieve 33% female gender representation on our Board and in our senior leadership team by 2021. In 2018, 25% of Board members and 33% of our senior leaders were women.

Our approach to diversity is supported by a suite of internal policies and training, which outlines how we expect our colleagues to treat one another in line with our values. These include: our Flexible Working Standard, Board Diversity Policy and our 'Speak Up' Policy. Diversity and inclusion training takes place when a colleague starts at the Society and every two years thereafter.

Our colleague-led Gender Diversity Forum, sponsored by Karen Wint (the Society's Chief Operating Officer), is responsible for improving our approach to gender diversity.

One of the steps we have taken is to work with Women Ahead. This aims to create a step-change in the number of women achieving senior leadership and Board roles by offering a cross-company and cross-sector mentoring programme. The scheme matches male and female leaders to mentor women from a different organisation.

A total of 40 colleagues have taken part in the scheme to date, including 20 of our female leaders who have received mentoring and 20 of our senior leaders, including Director of People, Chief Operating Officer and Chief Risk Officer, who have mentored women from other organisations.

Minimising our carbon footprint

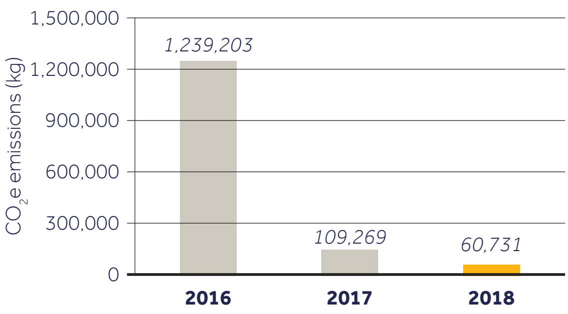
Since 2016 (our baseline year) the Society has reduced its emissions by 1,178,000 kg CO_2e using a 'market based' approach, which is the equivalent of taking 560 average sized cars off the road for a year[8]. This method of reporting reflects the decision we have taken to purchase 100% renewable electricity, backed by *Renewable Energy Guarantees of Origin* (REGO) certificates, for all our sites. This has had a particularly significant effect on our emissions, as the majority of our office sites use electricity for their primary sources of heating, which can be decarbonised.

Using a location based approach, which does not include the purchase of renewable electricity, our emissions have decreased by **508,000 kg CO_2e** since 2016.

8. Based on average-sized petrol cars off the road (each doing 7,100 annual mile average)

The Society is currently reporting its direct and indirect emissions relating to energy use at office sites (scope 1 and scope 2)[9]. We use the UK Government's emission factors for each year of reporting.

Carbon footprint



CARBON TRUST STANDARD
REDUCING CO2 YEAR ON YEAR

2018 marked the second year of the Society holding the Carbon Trust Standard for Carbon. This is a voluntary certification and mark of excellence reflecting the steps we have taken to reduce our carbon footprint.

Market based approach

CO_2e emissions (kg)	2016	2017	2018
Scope 1			
Diesel	6,285	2,410	**0**
Gas	101,832	106,859	**60,731**
Total scope 1	108,117	109,269	**60,731**
Scope 2			
Purchased electricity	1,131,086	0	**0**
Total scope 2	1,131,086	0	**0**
Total footprint	**1,239,203**	**109,269**	**60,731**

Location based approach

CO_2e emissions (kg)	2016	2017	2018
Scope 1			
Diesel	6,285	2,410	**0**
Gas	101,832	106,859	**60,731**
Total scope 1	108,117	109,269	**60,731**
Scope 2			
Purchased electricity	1,532,932	1,336,002	**1,072,564**
Total scope 2	1,532,932	1,336,002	**1,072,564**
Total footprint	**1,641,049**	**1,445,271**	**1,133,255**

9. Carbon data is unaudited and a proportion of the Society's electricity and gas data is based on estimated meter readings. We are committed to ensuring data is as robust as possible for carbon reporting and the Society is in the process of installing automated meters at all sites across the UK.

Corporate Responsibility

Continued

Sustainable & Responsible

Sustainable & Responsible means safeguarding the long term interests of current and future members, as well as operating to the highest standards of trust and integrity in everything we do.

In 2018, we responded to feedback from the public and members and took action to improve our tax transparency. This year's Annual Report & Accounts has also been printed on FSC sourced paper, produced from well managed forests.

Paying our tax fairly

In 2018, the Society became the first national high street financial institution to be certified with the Fair Tax Mark. This recognises our commitment to pay the right amount of corporation tax, at the right time and in the right place. The public has voted tax avoidance as the number one business ethics issue over the past five years[10], and our members and colleagues told us transparency was an area they wanted us to focus on.

Tax pays for health, education and many other vital public services, which our members and colleagues rely on. We also recognise it helps to create the strong foundations we need to thrive as a business in the long term.

In 2018, the Society paid over £23 million in corporation tax with an average current tax rate over the last four years (excluding the banking surcharge) of 19.5%. Together, including the bank levy and taxes paid as part of its responsibilities as an employer, the Society has contributed almost £55 million in 2018, through payment of taxes.

Tax payments made by the Society	**£'000**
– Corporation tax	23,320
– Banking surcharge (plus Irish bank levy)	7,854
– Value Added Tax (VAT)[11]	4,293
– Employers National Insurance contribution	4,754
– Business rates	2,110
– Apprenticeship Levy	226
Taxes paid by colleagues collected on behalf of HMRC	
– PAYE (income tax)	8,890
– Employees National Insurance contributions	3,370
Total tax contribution	**54,817**

Fair Tax 2017–18

Paying tax fairly has always meant holding ourselves to high standards. This is articulated in our tax strategy, which can be found on the Society's website. Launched in 2018, this publicly commits us to:

- Not maintain any connection to tax havens, other than for legitimate trading activity with the purpose of serving the local community in that jurisdiction.
- Not use marketed or abusive tax avoidance schemes, which are likely to fall foul of tax avoidance legislation in any jurisdiction in which we operate. This means we act in the spirit of what the law intends, not just following it to the letter.
- Seek to declare profits in the jurisdiction where their economic substance arises and report our tax position clearly in our Annual Report and Accounts. Full disclosures including country by country reporting can be found on page 180.

Internal Ratings Based (IRB) permission

Our stakeholders identified 'financial strength' as a key responsible business issue we must remain focused on.

In 2017, the Society set a target to hold our CET 1 Capital ratio over 14%, giving members confidence in our financial position.

In 2018, the Society secured Internal Ratings Based (IRB) permission from the Prudential Regulation Authority (PRA).

10. Source: https://www.ibe.org.uk/userassets/surveys/ibe_%20attitudes_survey_2018.pdf
11. The Society is only able to reclaim a proportion of VAT paid for products and services purchased.

By granting this permission, the PRA confirmed the Society is able to assess its own capital requirements for credit risk associated with residential mortgages. This decision reflects how we measure, manage and control risk effectively and, in turn, means the Society can continue to focus on what matters to our members and help even more people to save and have the home they want.

To ensure our external target to 'maintain financial strength and ability to grow' remained appropriate under IRB, the Society's Executive Committee took the decision to change the metric to a Total Capital Ratio basis – this shows the capital the Society holds relative to its risk weighted assets. The Society will aim to maintain its Total Capital Ratio over 20% until the end of 2020, providing protection against unexpected losses.

Listening to our members

Our online member forum, TalkingPoint, remains a source of valuable feedback for the Society. It has informed many of the decisions we have taken over the last 12 months. Our external target to grow the number of actively engaged members on TalkingPoint was met in 2017. There are now 2,971 active members providing input on a range of topics; including what members need from a variable ISA product and what it means to be a member of a mutual.

Benchmarking our performance

The Society is a member of Business in the Community and the Prince's Responsible Business Network. In 2018, we took part in its Responsible Business Tracker®. This tool is aligned with the United Nations Sustainable Development Goals (SDGs) and measures performance across a range of responsible business indicators. This feedback will be used to inform the Society's future approach.

BUSINESS IN THE COMMUNITY The Prince's Responsible Business Network

Ethical pension option introduced

To dovetail with our own responsible business strategy, the Society has introduced an ethical pension fund which colleagues can opt into. This invests in companies that meet ethical and environmental guidelines, including filtering out companies significantly involved in water pollution, intensive farming, gambling, adult entertainment, weapons manufacturing and tobacco sales.

Corporate responsibility strategy governance

Corporate Responsibility Steering Group

The Corporate Responsibility Steering Group is responsible for providing strategic direction for corporate responsibility at the Society, supporting the integration of corporate responsibility into the way the Society operates and for ensuring the Society is on track to deliver on its 2020 targets. In 2018, it was chaired by Richard Fearon, the Society's Deputy CEO.

During the year the steering group has discussed feedback from non financial ratings agencies, reviewed internal metrics and external targets, discussed future trends, appraised progress against key accreditations and has prepared an update for the Board of Directors.

Alongside the Corporate Responsibility Steering Group, the Society has a number of other working groups focusing on specific corporate responsibility priorities. These include a mental health forum, gender diversity forum and vulnerable customers working group.

Policies and standards

Policies and standards underpin our responsible business strategy, setting out how colleagues are expected to behave and the parameters for decision making.

The Society's Speak Up Policy enables colleagues to report concerns either anonymously or openly via email, telephone, web reporting, freepost or fax – 24 hours a day, 7 days a week, 365 days a year. The Information Technology Risk and Data Protection Policy means the Society must not retain personal data for longer than necessary, while the colleague policy ensures fair, transparent and consistent treatment of colleagues.

The Society's tax strategy, Board Diversity Policy and modern slavery statements can be found on our website.

Approval of the Strategic Report

This Strategic Report (on pages 2 to 43) has been approved by the Board of Directors and is signed on behalf of the Board.

Robin Litten
Chief Financial Officer

26 February 2019

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. It underpins the Society's ability to deliver our strategy, grow the business and promote the long term sustainable success of the business, creating long term value for our members and wider society.

Our culture and values are at the heart of what we do. The Board receives regular updates to enable the ongoing assessment of the standards of our business conduct, as well as a dashboard that measures culture, We consider the Society's performance against an agreed framework, which is influenced by the work of the City Values Forum. We have a strong culture of openness, accountability and respect across our business and will continue to place focus on this.

A key priority is to ensure the Board remains effective in its performance. In 2018, we appointed Independent Audit Ltd to facilitate our annual effectiveness review. I am pleased to report the outcome concluded that the Board, including the directors and committees, is operating effectively.

To continue the Society's success into the future, we make sure we have the appropriate skills and expertise to run the business in the long term, best interests of our members and to meet our strategic priorities. The Society firmly believes in the benefits of a diverse Board membership and seeks a broad range of skills, experience, backgrounds and opinions. The Nominations Committee devotes a significant amount of time to succession planning and following the release of strong results for the first half of the year, the Society announced the retirement of Peter Hill, our Chief Executive Officer (CEO). Peter has been CEO for seven years and I would like to thank him for his significant contribution to the success of the Society throughout his term of office and also for his representation of mortgage lenders, as a Board member of the financial services trade association, UK Finance.

Peter will be succeeded by Richard Fearon, the current Deputy Chief Executive Officer, from 27 February 2019. Richard joined Leeds Building Society three years ago. Before joining the Society, Richard spent 10 years at Lloyds Banking Group, where he held a number of senior roles in both the mortgage and savings businesses. He started his career at management consultants Oliver Wyman and Company. Richard has the skills and capability to lead the Society through the next stage of our development.

Les Platts retired from our Board on 31 December 2018, after serving eight years. Les has provided valuable insight as a non executive director, Chair of the Remuneration Committee and Senior Independent Director. I would like to take this opportunity to thank him for his wisdom and insight.

Following a successful recruitment process, we recently welcomed two new non executive directors. Both are respected professionals within the financial services industry and each brings with them over 30 years of relevant sector experience.

Details of our new appointments can be found in the Nominations Committee report on page 64.

Our new non executive directors will be seeking election to the Board for the first time at our Annual General Meeting in April 2019, I ask you to support all of the director nominations. A biographical summary for each director can be found on pages 45 to 47. As Peter Hill and Les Platts are retiring from the Board, they will not be seeking re-election.

The Board's approach to corporate governance is based on the principles and provisions of the UK Corporate Governance Code (the Code), of which the 2016 version was updated in July 2018. The revised code will be effective for accounting periods on or after 1 January 2019 and the Society is well placed to meet the new requirements.

We have continued to comply with the provisions of the 2016 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 2018 and applied the provisions of the Code.

Robin Ashton
Chairman

26 February 2019

Board of Directors

Key to Board Committees:

- A Audit Committee
- B Board Risk Committee
- N Nominations Committee
- R Remuneration Committee
- ◯ Committee Chair

Robin Ashton
Chairman
N

Appointed: Chairman March 2013 and independent non executive director in April 2011

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

As Chair, he is responsible for overseeing the performance of the Board of the Society. He is a strong supporter of the building society sector and the mutual business model, which plays an important role in UK financial services.

Other roles: Robin is the 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 general manager (sales) before moving into operations and was appointed Operations Director in 2006.

In 2011 he was appointed as Chief Executive Officer with responsibility for developing and proposing the Society's strategy, objectives and plans, and maintaining the Society's business model and culture.

Peter brought a breadth of experience from over 39 years' in retail financial services. He is an Associate of the Chartered Institute of Bankers and a fellow of the Royal Society of Arts.

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

Peter retires from the Board on 26th February 2019

Richard Fearon
Deputy Chief Executive Officer

Appointed: February 2016

Skills, competence and experience: Richard joined Leeds Building Society as Chief Commercial Officer and was appointed as Deputy Chief Executive Officer in August 2018.

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 has an excellent understanding of product development to meet customer needs, as well as strong strategic and commercial skills. Richard is currently responsible for the Society's strategy and direction across customer and digital, product development, direct and intermediary distribution as well as change management. He is Chair of the Corporate Responsibility Steering Group and Conduct Risk Committee. With effect from 27 February 2019 Richard will succeed Peter Hill as the Society's Chief Executive Officer. The Board firmly believes that Richard has the skills and capability to lead the Society through the next stage of its development.

Other roles: Richard is a member of the UK Finance Mortgage Product Board and member of the Business in the Community Yorkshire & Humber Advisory Board.

Annette Barnes

Independent non executive director | **Appointed:** February 2019

Skills, competence and experience: Annette joined the Board in February 2019, having over 30 years' experience within financial services.

Prior to joining the Society, Annette was most recently CEO at Lloyds Bank Private Banking Ltd and Managing Director of Wealth & Mass Affluent for Lloyds Banking Group. Her background in operations, technology and customer experience, combined with her recent board and regulatory experience, will further strengthen our Board. Annette is a member of the Society's Board Risk Committee.

Other roles: Annette is a non executive director at GlobalData plc.

Philippa Brown

Independent 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: Philippa is the Chief Executive Officer of Omnicom Media Group UK Ltd and a director of Future Dreams Trust Ltd.

Iain Cornish

Independent non executive director | **Appointed:** January 2019

Skills, competence and experience: Iain joined the Board with over 30 years' experience working in financial services and was Chief Executive of Yorkshire Building Society between 2003 and 2011. During 2007/8, Iain was Chairman of the Building Societies Association. He has also held a number of non executive posts, was a Treasury Select Committee Special Advisor and Independent director for the PRA and he also chaired the Financial Services Authority Practitioner Panel.

In addition to significant experience of the sector, Iain has relevant Risk and Audit Committee experience. Iain joined the Board on 1 January 2019 and is a member of the Society's Audit Committee and Board Risk Committee.

Other roles: Iain is the Chairman of St James Place plc; Senior Independent Director of Arrow Global Group plc and a Trustee and Treasurer of Macmillan Cancer Support.

David Fisher

Independent non executive director | **Appointed:** March 2012

Skills, competence and experience: David has 30 years' experience within financial services, beginning his career with Halifax Building Society.

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 strong understanding of risk management, pensions and human resources.

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.

Other roles: David is a non executive director at P2P Global Investments plc.

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.

Gareth Hoskin

Independent non executive director | **Appointed:** November 2015

Skills, competence and experience: Gareth has gained extensive experience acquired over his 30 year career in UK and international financial services, as a director of Legal & General plc and CEO of its International Division, and previously as a Chartered Accountant at Price Waterhouse. With effect from 1 January 2019 and, subject to regulatory approval, Gareth was appointed as Vice Chairman and Senior Independent Director. As Chair of Audit Committee, his responsibilities include safeguarding the independence of the Internal Audit function and he is the Society's Whistleblowers' Champion.

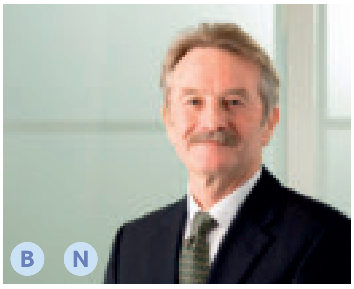
Other roles: Gareth is a non executive director, Trustee and Audit Committee Chair of Diabetes UK Ltd and Advisor to the Board of Green Park Partners Ltd.

John Hunt

Independent 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. John is a member of the Board Risk Committee.

Other roles: John is a director of JCH Associates Ltd.



Phil Jenks

Independent non executive director | **Appointed:** March 2012

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

Other roles: Phil is the Deputy Chairman of Broadlands Finance Ltd, and a non executive director of Charter Court Financial Services Group and its subsidiaries.

Robin Litten

Chief Financial Officer | **Appointed:** January 2012

Skills, competence and experience: Robin joined the Society in 2012 having spent the previous 17 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 our members. As a member of the Executive Committee, he leads the Society's finance, treasury and planning activities and is Chair of the Assets and Liabilities Committee and Credit Committee.

Lynn McManus

Independent 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, HR and communications and her most recent role was at Clydesdale Bank, where she was a member of the Executive Team. Lynn is a Chartered Management Accountant. Lynn is the designated non executive for workforce engagement and a member of the Audit Committee. With effect from 1 January 2019 and, subject to regulatory approval, Lynn was appointed as Chair to the Remuneration Committee. In this role, she is responsible for overseeing the development of, and implementation of, the Society's remuneration policies and practices.

Other roles: Lynn is a director of Kane LMMG Ltd.

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 and technology to deliver great service and value to our members. Karen is Chair of the Operational and Regulatory Risk Committee and is the executive accountable for meeting the Society's targets under the Women in Finance Charter.

Corporate Governance Report

Year ended
31 December 2018

The role of the Board

The Board considers good corporate governance and a strong risk management framework to be 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. It establishes a governance framework and practices to facilitate the Board's 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 members.

The Board sets the tone from the top and provides oversight of management's role in establishing and maintaining the Society's 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 on page 55.

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 external auditors; 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 2018 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.

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 51 to 53.

Powers are delegated from the Board to the 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. These are reviewed and approved by the Board at least annually.

Board activity

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

Strategy	• Updates from the Chief Executive Officer on performance against corporate objectives, a risk overview, key business priorities and a summary of the economic outlook • Strategic outlook • Strategy and planning conferences • Approval of and monitoring performance against the corporate plan and strategic objectives • Strategic analysis and presentations on 'horizon' based themes, such as millennials and generation Z, disintermediation of the mortgage market and digital disruption • Corporate responsibility strategy update • Business change and project activity updates • Reviews of the competitive and external outlook • Reviews of the economic environment, including the Monetary Policy Committee's interest rate decisions • Annual review of the pricing methodology and key assumptions • Vision scorecard • Annual review of the legacy portfolios
Members	• Monthly updates from the Chief Commercial Officer on mortgage and savings business performance and customer complaints • Annual complaints report • Approval of the AGM resolutions, plans and logistics • Approval of the minutes of the AGM and a review of the meeting • Quarterly customer and intermediary satisfaction and research reports • A mutuality review • An update on customer centricity

Risk	• Monthly updates from the Chief Risk Officer on performance against corporate priorities, a risk overview and key business priorities • Annual approval of risk appetite • Annual review of lessons learned during the year • Annual review of the Society's systems and controls • Annual Money Laundering Reporting Officer's Report, including approval of the Prevention of Financial Crime Policy • Approval of 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 • Minutes and updates from the Board Risk Committee • Cyber security strategy and training • Approval of the technology strategy • Interest only update focusing on the term end actions and performance of the book
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, announcement sign off and Pillar 3 disclosures • Quarterly forecast reviews
People	• Monthly updates from the Chief Operating Officer on people matters • Appointment and re-appointment of non executive directors • Chairman's appraisal • Chair/Vice Chair/Senior Independent Director appointments • Division of responsibilities between the CEO and the Chairman • Succession planning and talent management • Non executive pay review • Annual approval of the 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
Governance	• Board effectiveness review (externally facilitated) • Board culture evaluation • 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

Corporate Governance Report

Year ended
31 December 2018

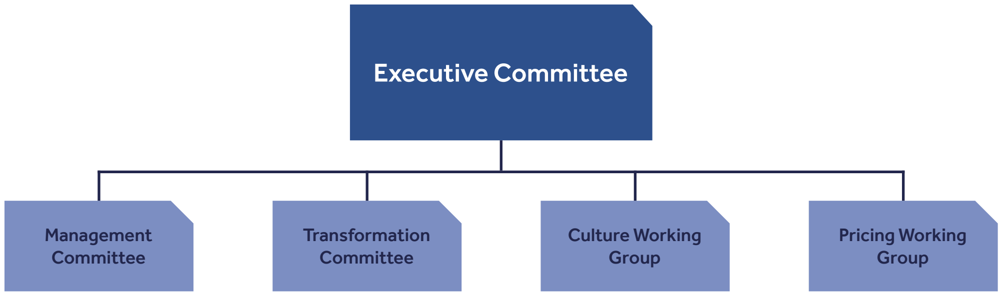
Continued

Executive management committees

There are five executive management forums to support the CEO in managing the business: the Executive Committee, the Management Committee, the Pricing Working Group, the Culture Working Group and the Transformation Committee.

In 2018, a new Transformation Oversight Group was set up, comprising non executive and executive directors, with the aim of providing additional insight into the transformation activities underway within the Society. This group does not form part of the formal governance structure.

The executive management committee structure is outlined below:



Executive management committee terms of reference

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 the balanced scorecard to facilitate early identification of divergence from plan and agree/monitor remedial action. 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 and the Culture 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/monitor remedial action(s), 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 Programme 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/enhancements.

The Culture Working Group (CWG)

The primary purpose of the CWG is to support the executive and management committees in the development and maintenance of the Society's culture.

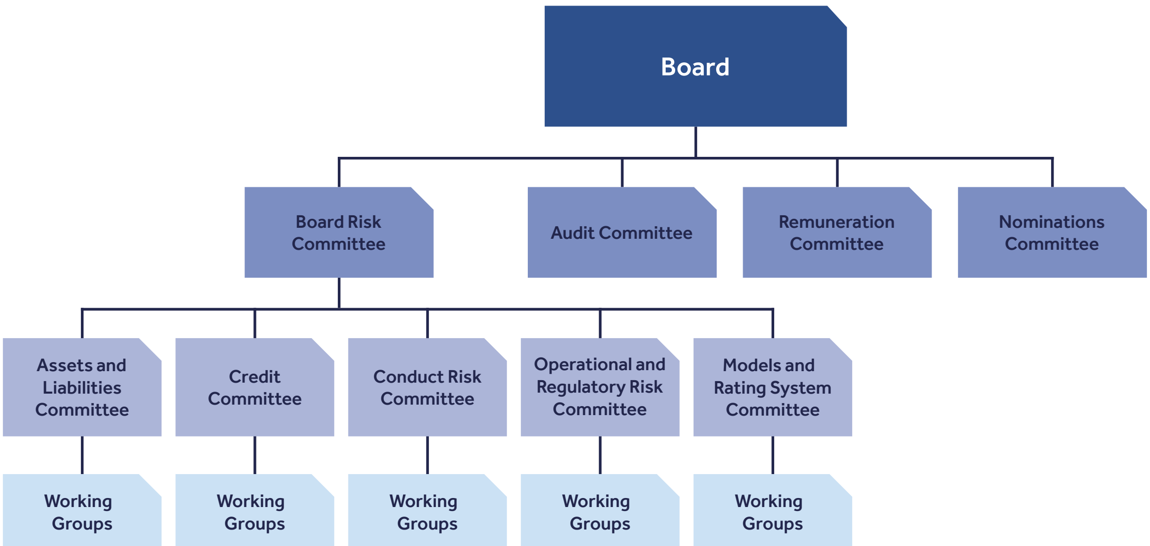
The Pricing Working Group (PWG)

The primary purpose of the PWG is to approve new product pricing for the Society's savings and mortgage products. The aim is to offer value to members, achieve business volume (to support long term growth), achieve margin and membership growth whilst considering the Society's strategic aims, impact on operations, customer experience and agreed risk appetite statements and limits.

The Board and its 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 Board 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.

The Board committee and management governance structure is outlined below:



Legend:
- NED only membership
- Executive and SME membership
- Committee: Senior Management and SME membership

Corporate Governance Report

Year ended
31 December 2018

Continued

Board and Board committee Terms of Reference

The Board

The Board is accountable to the members of the Society and is primarily 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 Prudential Regulation Authority (PRA) and the Financial Conduct Authority (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.

The BRC is supported by five management committees.

Audit Committee (AC)

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 auditors.

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 and senior leaders. The committee also ensures that performance related elements of remuneration are transparent, stretching and rigorously applied, having regard to risk appetite, member views and other stakeholders.

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.

Board Risk Committee (BRC)
The Chair of the BRC is David Fisher and the other members of the committee during 2018 were Phil Jenks, Gareth Hoskin and John Hunt.

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

Further details on the risk governance framework are set out on pages 66 to 70. Commentary on the types of risks faced by the Society, together with details of how these risks are managed, are set out on pages 14 to 21 and in notes 31 to 34 to the accounts on pages 144 to 160.

Audit Committee (AC)
The Chair of the AC is Gareth Hoskin and the other members of the committee during 2018 were Les Platts, David Fisher and Lynn McManus.

Further details on the work of this committee can be found on pages 71 to 79.

Nominations Committee (NomCo)
The Chair of the NomCo is Robin Ashton and the other members of the committee during 2018 were Les Platts and Phil Jenks.

Further information on the work of this committee can be found in the Nominations Committee Report at pages 62 to 65.

Remuneration Committee (RemCo)
The Chair of the RemCo during 2018 was Les Platts and the other members of the committee during 2018 were David Fisher, Philippa Brown, Gareth Hoskin and Lynn McManus.

The new Chair of the committee (to replace Les Platts), with effect from 1 January 2019, is Lynn McManus (subject to regulatory approval).

Further information can be found in the Directors' Remuneration Report at pages 80 to 94.

Models & Ratings System Committee (MRSC)
The MRSC was a Board committee until the end of March 2018 when it was re-designated as a management committee. Prior to its re-designation, the Chair of the MRSC was John Hunt. The other non executive member of the committee during 2018 was Phil Jenks and other Board members of the committee were Robin Litten and Andrew Greenwood.

The MRSC now supports the Board, through its reporting line into BRC, in fulfilling its oversight responsibilities for the IRB (Internal Ratings Based) ratings system and general credit modelling.

Terms of Reference (ToR)
The schedule of matters reserved for the Board and the ToR 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.

Corporate Governance Report

Year ended
31 December 2018

Continued

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)			5 (5)		
Philippa Brown	8 (10)				4 (4)	
Richard Fearon*	10 (10)					
David Fisher	10 (10)	6 (6)	8 (8)		4 (4)	
Andrew Greenwood*	10 (10)					1 (1)
Peter Hill*	10 (10)					
Gareth Hoskin	10 (10)	6 (6)	8 (8)		4 (4)	
John Hunt	10 (10)		8 (8)			1 (1)
Phil Jenks	10 (10)		7 (8)	5 (5)		1 (1)
Robin Litten*	10 (10)					1 (1)
Les Platts	10 (10)	6 (6)		5 (5)	4 (4)	
Lynn McManus	10 (10)	6 (6)				
Karen Wint *	10 (10)					

*executive directors / chief officers

** The MRSC was a Board committee until the end of March, 2018 when it was re-designated as a management committee

Board roles

The roles of the Chairman and CEO are distinct and are held by different people. 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. As members of the Board and Board committees, they assist in the discharge of the obligations of the committees in line with the ToR. They also have a responsibility to be sufficiently and appropriately informed of the matters under discussion and to represent and have regard to the interests and views of current and future members of the Society.

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.
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 FCA business activities via the Society's management forums, in line with the Society's risk management framework.
Member/ Customer	To ensure the fair treatment of members/customers.

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 processes. • To support the CEO in the development of strategy and more broadly to support and advise the CEO. • 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 unite 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 CEO. 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 review the Chairman's performance and carry out succession planning for the Chairman's role. • To deputise for the Chairman and chair meetings where the Chairman is conflicted.
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 auditors 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 18 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 by the secretariat team.

Corporate Governance Report

Effectiveness

Board composition

As at 31 December 2018, the Board comprised 13 directors, of whom five were executive directors and eight were 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 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 the current mix of directors' skills, experience, background and opinions complement each other and provide an appropriate balance. This helps ensure members' interests are protected and the business 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.

Appointments to the Board

The Board considers and acts upon recommendations for appointments from the NomCo. Details of the appointment of Peter Hill's successor and the appointment of two new non executive directors can be found in the Nominations Committee Report on pages 62 to 65. All directors must meet the tests of fitness and propriety prescribed by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) and 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. In accordance with the revised Code, a template appointment letter will be held on the Society's website.

Board diversity

To reflect the importance placed on gender diversity, the Board has agreed a target of 33% for females on the Board, by 2021. As at 31 December 2018, three members of the Board were female representing 23% of the total Board membership. In terms of the wider senior leadership team (the Society's top three levels of management), the current population is 93, of which 31 are female. This equates to 33% 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 its values.

Board Diversity Policy:

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 Nominations Committee 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 Nominations Committee 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 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 Nominations Committee will report annually in the corporate governance section of the Leeds Building Society Annual Report and Accounts on the agreed objectives and the progress against these objectives and 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 to the representation of women in senior roles. It also believes it is important to consider elements of diversity beyond gender and has developed a single statement ambition:

To have an *inclusive culture*, which enables colleagues with a diverse range of skills, experiences, backgrounds and opinions to flourish, without barriers.

The Society's strategic aims for the diversity and inclusion strategy are:

To **attract, retain and nurture** the best talent to help them realise their potential, responding to changing workforce requirements by evolving Society working practices and approaches.

For the workforce to **share and contribute to the Society's purpose** and be rewarded appropriately for its success.

To create an organisation whose people, at all levels, **represent the opinions and perspectives of the communities served** by the Society.

To **harness the benefits of a diverse workforce**, through high colleague engagement and an inclusive, open culture, demonstrated through living the Society's values.

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

Corporate Governance Report

Gender pay

The Society welcomes the move to drive the fairness of pay for women, having introduced a Fair Reward approach in 2014. This helps to objectively determine salaries 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 61% of its workforce is female. However, there are more men than women in senior and, therefore, more highly paid roles. This means there is a gender pay gap. Further information can be found on the website: www.leedsbuildingsociety.co.uk/_resources/pdfs/your-society-pdfs/lbs_gender_pay_gap.pdf

Gender diversity is taken seriously. 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 have agreed development actions which are 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 is also essential and will inform Board or committee discussions and decisions.

In addition to the annual performance evaluation of individual non executive directors by the Chairman, mid-term personal development plan reviews also took place. The Board evaluates the Chairman's own performance at a meeting when he is not present. Feedback is then provided to him by the Senior Independent Director.

Executive directors, including the CEO, are evaluated annually within the framework for all colleagues of the Society and by the Remuneration Committee, 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. As the previous externally facilitated review was conducted in 2015, the Board sought the services of Independent Audit Ltd to undertake this year's review. A slightly different approach was followed, whereby a questionnaire was issued to each Board member, the Secretary and the Director of People. This was followed by one to one discussions, then a facilitated discussion session with the whole Board. The outcome of the review concluded that the Board, including the directors and Board committees, were operating effectively. While no significant matters were reported, a number of actions were agreed and these included the need for continued focus on Board diversity, longer term succession planning (factoring in a need to recruit digital and transformation skills) and the further development of a framework to support the pipeline of in house talent.

All Board committees also evaluate their own performance and effectiveness annually. This process serves to identify any areas where members may require further training or development in order to discharge their duties effectively, or where the overall performance or approach of the Committee could be improved.

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 2018.

The Board 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.

Independence

None of the non executive directors have been recent employees of the Society, held a material business relationship with the Society, received any additional fees other than their director's fee or have close family ties or significant business links to other directors.

The Board's annual review of potential conflicts of interest did not identify any relationship or conflict which would impair a non executive director's ability to meet the independence criteria set out in the Code.

The Board considers all non executive directors to be independent in character and judgement and that there are no circumstances which are likely to impair independence.

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 an Enterprise Risk Management Framework (ERMF) which encourages a culture of sound risk management and internal control. The ERMF facilitates robust risk assessment and requires the effectiveness of risk management and internal control systems to be monitored and reviewed. In 2018, the Society was proud to gain regulatory permission 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.

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 ERMF can be found on pages 66 to 70. Details of the role and responsibilities of the Audit Committee can be found on pages 71 to 79.

The Board is satisfied with the effectiveness of the governance processes which have operated under the ERMF and that during 2018, 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/undertaking reviews of internal reports, as well as following completion of the external audit, the directors consider, taken as a whole, the Annual Report and Accounts to be fair, balanced and understandable and that they provide 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 pages 73 to 77.

The Society's statement on going concern is on page 97. Details of why it is considered appropriate to adopt and how this was arrived at can be found in the Audit Committee Report on page 77 and the assessment of and future prospects for the Society and the period to which it pertains can be found in the longer term viability statement, in the Strategic Report, on pages 22 to 23.

Remuneration

The annual report on remuneration and details of the Society's Remuneration Policy can be found in the Directors' Remuneration Report on pages 80 to 94.

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 are encouraged in a number of ways:

Stakeholder engagement

The Board recognises that the Society has a number of internal and external stakeholders, including members, investors, colleagues, suppliers and regulators, In discharging its duties, the Board considers proposals and makes decisions with relevant stakeholders in mind, being mindful to understand the actual or potential impact, before approval or support is granted.

Corporate Governance Report

Year ended
31 December 2018

Continued

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 and how the Society can make its products and services even better. With TalkingPoint, an online 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 active members since its launch in 2015 and now has almost 3,000 active members, with more than 80% of these members taking part in research.

Members are encouraged to engage with the Society and each other. A number of forums and research activities have been created. Some of the recent research conducted with TalkingPoint members includes:

- Asking members for their views and opinions on the 2018 AGM;
- Asking members to test draft communications to ensure they drive the right action (e.g. what members understand, value and think is important about mutuality);
- Asking members about their media consumption. This included TV, radio, online news, printed press and social media. This research enables the Society to share information in the most effective way;
- Asking members to rank 21 potential service/product improvements in order of importance. Members were consulted on the new variable saver product from the minimum balance to interest rates, both of which were changed to make the product more attractive;
- A mini poll for members' preferred price points for charity Christmas cards; and
- A mini poll for selecting the name of the new variable saver product 'Smart Saver'.

More information can be found on the website: www.leedsbuildingsociety.co.uk/your-society/

Complaints process
The Society's commitment to its customers is enshrined in the mission statement: *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 members. Sometimes mistakes and misunderstanding do occur, and 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 guide that outlines the procedure for raising a complaint with the service received from the Society can be found on the website: www.leedsbuildingsociety.co.uk/resolving-problems/

The Annual General Meeting (AGM)
The AGM is a key event for members to have their say on the way in which the Society is run. The next meeting will be held on Thursday 4 April 2019 at 11.00am at the Marriott Hotel, Leeds. 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.

Further information on member engagement can be found in the Corporate Responsibility section of the Strategic Report on pages 34 to 43.

Suppliers
The Society's supplier partners are an essential part of its business operations and key to the ability to develop and deliver services to members. It is important that third parties represent the Society in a manner which supports and enhances its reputation, as well as relationship with members, colleagues and other stakeholders. Consequently, the Society aims to partner with organisations that show a commitment to its mutual values, ethics, policies and standards.

Community
The Society supports a wide range of local and national communities and charities, as well as being partnered with Samaritans. Further information can be found in the Corporate Responsibility section of the Strategic Report on pages 34 to 43.

Relations with other investors
The Society's Treasury team has developed a programme for investor relations, which includes presentation of the annual results at an invited event in the City of London, as well as holding individual meetings with key institutional investors after the publication of the full year and interim results. Regular meetings with both existing and new investors are also held on an ongoing basis throughout the year. Attendance at investment conferences and specially arranged investor events provide the opportunity for additional engagement with investors.

Regular and close dialogue is maintained with credit rating agencies, Fitch and Moody's. A formal review meeting is held on an annual basis with each agency. At other times a close relationship and regular dialogue is maintained.

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

Robin Ashton
Chairman

26 February 2019

Nominations Committee Report

Year ended
31 December 2018

Dear member,

I am delighted to present our first standalone report on the Nominations Committee, which reviews our work over the past year. The committee is appointed by the Board and was in place throughout the year, meeting five times. Following each meeting, I provide an update to the Board on the matters discussed and agreed.

The Nominations Committee comprises three independent non executive directors.

Committee members

Robin Ashton (Chair)	Member since March 2013
Les Platts	Retired December 2018
Phil Jenks	Member since January 2017
Gareth Hoskin	Member since January 2019

Les Platts retired from the committee in December 2018. Gareth Hoskin was appointed the new Senior Independent Director (subject to regulatory approval) and joined the Committee on 1 January 2019. Regular attendees of the Committee include Peter Hill and Richard Fearon. Other members of the senior management team are invited to attend, when appropriate. Attendance records for the meetings held in 2018 can be found in the Corporate Governance Report on page 54.

Terms of reference and key responsibilities

Board composition and effectiveness	The committee is accountable for ensuring that the Board, and its committees, consist of directors with the appropriate balance of skills, experience, backgrounds and opinions, to fully discharge their duties in a highly effective manner.
Succession planning	The committee is responsible for considering the succession planning of the Board, executive directors and senior leadership team.
Governance	The committee is responsible for ensuring that the Board meets the principles of the UK Corporate Governance Code (the Code) and sourcebooks and other appropriate requirements relevant to the remit of the committee issued by regulatory authorities.

Key areas of focus in 2018

Board composition

The committee reviewed the composition of the Board and its supporting committees to ensure they comprised a sufficient number of executive and non executive directors who meet the requirements as set out by the Senior Managers Regime. As part of this review, the current mix of directors' skills, experience, backgrounds and opinions were considered using a competency skills matrix. The review concluded that, in the main, there was a good level of diversity and coverage in respect of the Board's requirements. The review led to a small number of changes in respect of representation on Board committees. It is important that directors' skills complement each other and achieve an appropriate balance. This in turn ensures members' interests are protected and the business has appropriate leadership and direction.

The committee reviewed the length of service of each non executive director and the impact on Board committee membership of directors nearing the end of their term. This aided forward planning, promoted the continual refresh of skills and experience on the Board and, together with the composition review, provided insight and direction into the search process for new non executive directors.

Les Platts, Senior Independent Director, Chair of the Remuneration Committee and a member of both the Audit and Nominations Committees, retired as a non executive director in December 2018, after eight years on the Board.

Given the depth of their knowledge and experience, Gareth Hoskin was appointed into the role of Senior Independent Director and Lynn McManus was appointed the new Chair of the Remuneration Committee. Both positions take effect from 1 January 2019 (subject to regulatory approval).

Board re-appointments

Non executive directors are appointed for a three year period and are usually expected to serve two terms. These terms are subject to ongoing performance evaluations and to annual re-election by members of the Society. They may also be proposed for a third term, up to a maximum of a further three years.

Following the annual appraisal process and taking into account the skills and performance of the non executive directors, the committee recommended to the Board the term extensions for David Fisher, Phil Jenks and Philippa Brown for their third term.

On the same basis, the terms of office of John Hunt and Gareth Hoskin were also extended for a second term. The Board approved the appointments.

As recommended by the committee, each non executive director will receive a tailored refresher training programme.

The Chairman, Robin Ashton, has been a non executive director since April, 2011 and the Society's Chairman since March 2013. As reported last year, following a rigorous review and taking into account his depth of experience and skills, the committee recommended and the Board agreed to extend his directorship until April 2020. The matter of a potential successor has been the subject of attention for the committee during the year.

None of the non executive directors have been in office for more than nine years.

Diversity and inclusion

The Nominations Committee agreed the measureable objectives for Board diversity and reviewed the Diversity Policy, recommending them to the Board for adoption. This includes targets for gender representation and the policy on how to achieve that target.

The Society is also a signatory to the Women in Finance Charter and the committee noted progress is being made against the Society's action plan to improve the female talent pipeline. Further details can be found in the Corporate Governance Report (see pages 56 to 57).

Independence

The committee considered potential conflicts of interest to ensure the ongoing independence of non executive directors. These were noted on the Board Conflicts of Interest Register. The Board Conflicts of Interest Policy was also approved, having been revised to take into account new requirements within the 2018 UK Corporate Governance Code.

Board and committee effectiveness

Board effectiveness

The Nominations Committee is responsible for oversight of the conduct of the annual Board effectiveness review. An externally-facilitated review was due in 2018 and, following a formal tender process, Independent Audit Ltd was selected. Independent Audit Ltd has no other connections with the Society.

A report with its findings was provided to the committee for review in July 2018. This led to a request by the committee for further details in relation to the Society's current approach to talent management and development. The committee agreed that the use of an external facilitator every three years was still appropriate, but felt that varying the facilitator used would be beneficial to ensure a wide range of approaches are applied.

Committee evaluation

The committee evaluated its performance and effectiveness over the year in accordance with its Terms of Reference (ToR). The results of the review were discussed at the committee's meeting in January 2019. The overall conclusion was that the committee operated effectively.

Nominations Committee Report

Continued

As part of the annual review, the committee approved a number of changes to its ToR to bring it in line with the UK Corporate Governance Code (as revised in 2018). A copy of these ToR can be found on the Society's website.

Succession planning

Senior leadership talent and succession planning

The committee is responsible for recommending the appointment of new directors and members of the senior leadership team. This is done with a view to ensuring the continued ability of the organisation to compete effectively in the marketplace, for the long term.

The committee devotes a significant amount of time to succession planning and, as referenced in the Corporate Governance Report, the committee was responsible for overseeing the appointment of the new CEO.

Following the announcement of the new CEO appointment, a number of subsequent changes in the senior leadership structure were considered to ensure ongoing, collective capability and capacity within the senior leadership team. Some of the changes are subject to regulatory approval and will take effect in the first quarter of 2019.

Non executive director appointment and succession planning

Before a search and selection process commences, the succession needs of the Society and an evaluation of the balance of skills, experience, backgrounds and opinions on the Board, is undertaken. In the light of this evaluation, appointment criteria are determined.

During the year, recruitment and selection has been undertaken to search for two new non executive directors. In 2018, the committee appointed Warren Partners to assist in the search. Warren Partners have no other relationship with the Society and 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, including market mapping and reviews by members of the committee/non executive directors. Candidates were considered from a wide range of backgrounds. Selection was based on objective criteria, to aid in the identification of potential skills gaps.

In June 2018, on the recommendation of the committee, the Board approved the appointment of Iain Cornish as a non executive director. Iain joined the Board in January 2019 and will stand for election, for the first time, at the Society's Annual General Meeting on 4 April 2019. Iain brings with him an extensive knowledge of the building societies sector as well as wider financial services and regulatory experience.

In September 2018, on the recommendation of the committee, the Board approved the appointment of Annette Barnes as a non executive director. Annette joined the Board on 1 February 2019 and will also stand for election, for the first time, at the Society's Annual General Meeting on 4 April 2019. Annette brings with her extensive knowledge and experience of operations, technology and customer experience. Her substantial programme management, transformation and IT background will complement the skills of the Board.

Annette and Iain will be provided with tailored, induction and ongoing training. Their biographies can be found on page 46.

Governance

The committee conducted an annual review of the Society's governance arrangements and compliance with the 2016 version of the UK Corporate Governance Code. In 2018, the Society complied, as far as possible for a building society, with the provisions and principles of the Code. In the latter part of 2018, the committee had particular focus on the newly revised Code issued in July 2018, which became effective for accounting periods starting on or after 1 January 2019. A dedicated training session on the Code and its implications was presented to the committee in October 2018. The committee will continue to provide oversight and monitor the implementation of the actions needed to fully address the changes in the revised Code.

A number of annual reviews were undertaken by the committee, these included:

- A review of the required capabilities and the job descriptions for the roles captured by the Senior Managers Regime;
- An annual review of the Senior Manager and Certification Regime Selection Policy; and
- A review of Matters Reserved for the Board and the Division of Responsibilities between the Chairman and CEO.

The committee progressed with an agreed change to the governance structure arising from 2017, with the re-designation of the Models and Ratings System Committee from a board committee to a management committee. The new reporting line, through to the Board Risk Committee, reflects the maturity of the Society's modelling framework and best practice governance structures. The change took effect from 31 March 2018.

Key areas of focus in 2019

In the coming year, the committee will continue to focus on ensuring the Society has a strong governance structure. It will continue to provide ongoing oversight of the composition of the Board and succession planning, with particular emphasis placed on diversity (including but not limited to gender and ethnicity).

Further information on diversity, conflicts of interest, induction and development and board evaluation can be found in the Corporate Governance Report on pages 48 to 61.

On behalf of the Board.

Robin Ashton
Chair of Nominations Committee

26 February 2019

Board Risk Committee Report

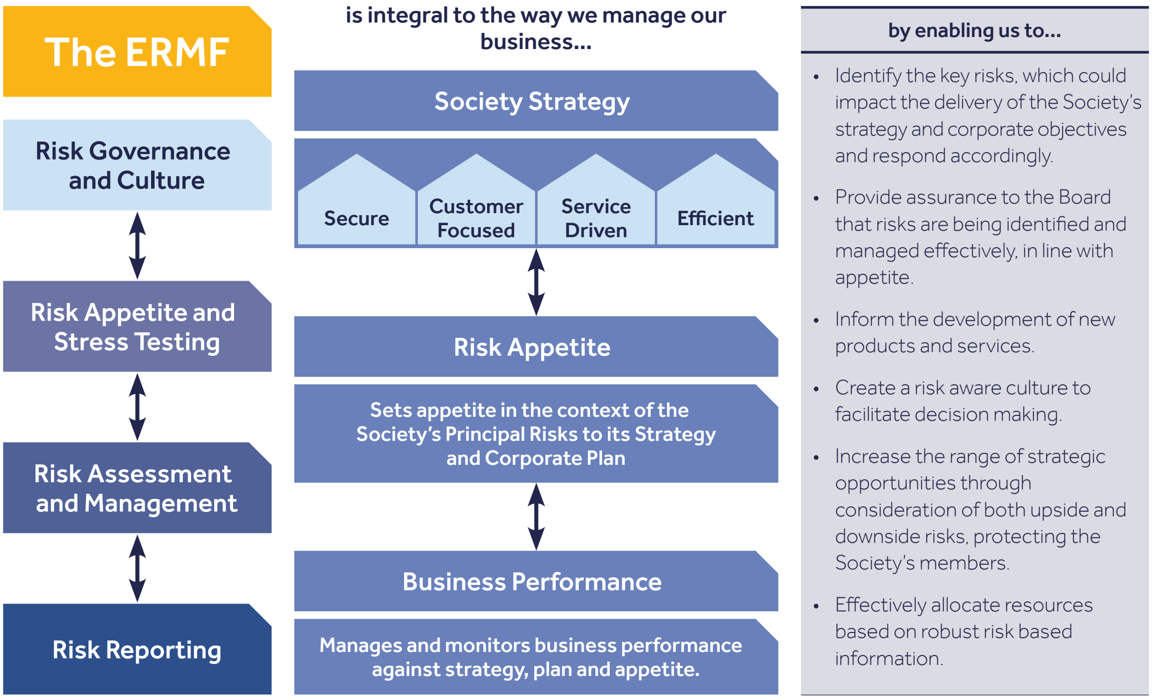
Year ended
31 December 2018

Dear member,

As Chair of the Board Risk Committee (BRC), I am pleased to present the 2018 Risk Management Report. This report provides an overview of the Society's approach to risk management and a summary of the main focus areas of BRC during the year.

Approach to risk management

The Enterprise Risk Management Framework (ERMF) integrates various risk management tools to support the effective development and implementation of the Society's strategy. The framework sets out a structured and consistent approach to identifying, assessing, controlling and monitoring risks, which is used to inform decision making at both strategic and operational levels. The ERMF is reviewed annually by the BRC, on behalf of the Board. The Chief Risk Officer (CRO) has responsibility for its implementation.



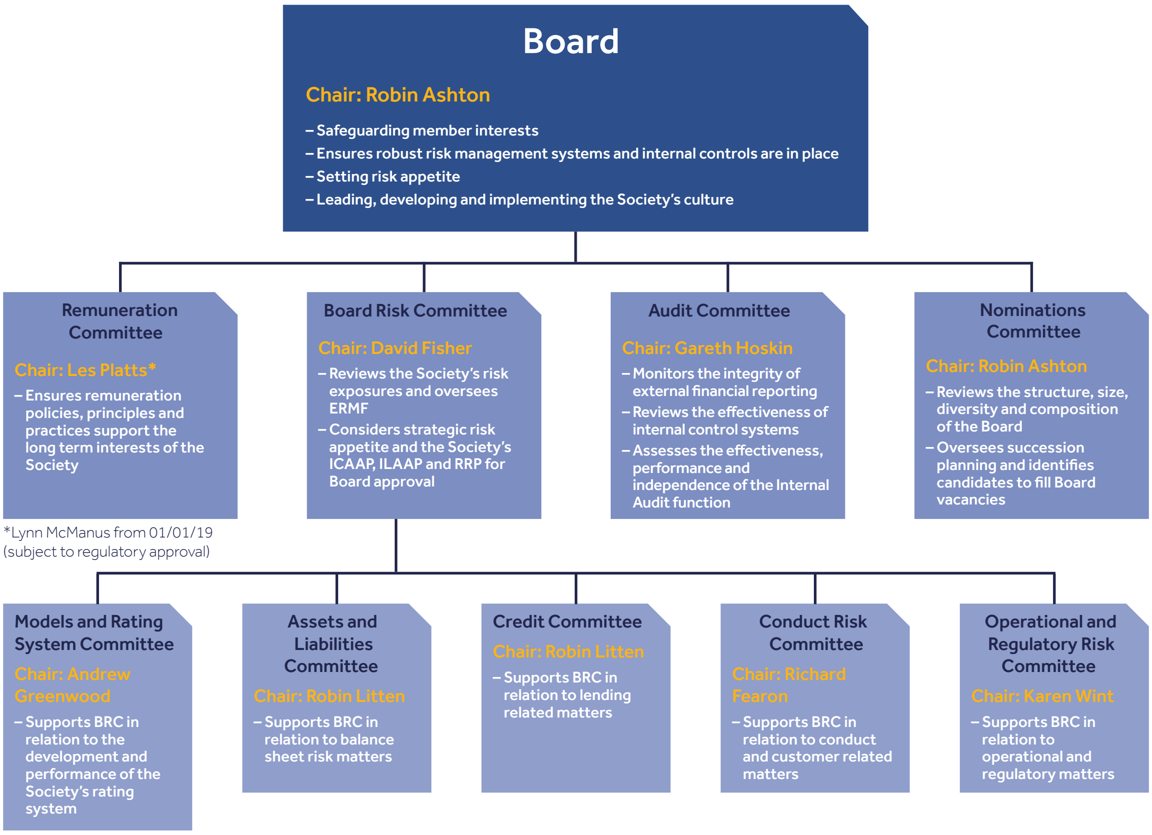
The main components of the ERMF are discussed below:

Risk governance and culture

Risk governance is the architecture used to support risk based decision making and oversight across all operations of the Society, whereas risk culture relates to the behaviours and attitudes of colleagues in making these decisions. These structures, disciplines and values support the Board in its fiduciary responsibility for risk oversight and delegate responsibility to management for day to day decision making.

Committee structure

The Board is the governing body of the Society and is responsible for overseeing the implementation of the Society's strategy and holding management to account. To support the Board in the delivery of its responsibilities, the Society operates four board subcommittees, each with distinct and cascaded mandates in their Terms of Reference (ToR). From a risk management perspective, BRC provides independent oversight of the effective management of the Society's risk universe. The BRC is supported by five Executive Risk Committees, each focusing on a particular discipline(s) of risk. These committees are decision making in nature and operate within delegated mandates and limits provided by the Board/BRC. The Society's committee structure as at the year end is set out below:



Policies and delegated authorities

Mandates are also provided by the Board to management via the following routes to manage the day to day activities of the Society:

Delegation route	Summary
1. Policy Framework	Delegated mandates and limits are approved through the Society's suite of policies, which are reviewed on an annual basis by the Board or relevant board sub committee.
2. Delegated Authorities Manual	The Delegated Authorities 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.
3. Corporate Plan	Subsequent to the approval of SRA, the Corporate Plan provides the annual Board approved parameters within which management can operate.

Year ended
31 December 2018

Continued

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. • Identifying and managing own risks. • Adhering to appetite, policies and standards. • Implementing and maintaining regulatory compliance. • Identifying emerging risks.	• Oversight of day to day activities of the first line. • Maintenance of the ERMF. • Coordination and oversight of the setting of risk appetite. • Guardians of policies. • Identifying emerging risks. • Enterprise risk reporting. • Conduct risk based independent assurance.	• Independent assurance of the adequacy and effectiveness of first and second line risk management, on a risk based approach.

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 CEO and is also accountable to the Chair of the 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 ERMF is embedded across the business and into decision making. The Society operates a risk aware culture, built upon the following four principles:

Tone from the top and desired behaviours – this reflects the Society's Values, which are 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 – an environment of open and transparent communication is cultivated about risk and risk taking expectations.

Incentives and talent management – the Society operates an appropriate incentive scheme and other HR frameworks to promote the desired risk culture.

Risk appetite and stress testing

Risk appetite framework

A key element of the ERMF is 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 19). Metrics are reviewed by the Board annually and are used in stress testing to measure and validate the long term viability of the Society, under both plausible and more severe scenarios. They are also assessed on a forward looking basis, within the corporate planning process.

The Board receives monthly management information on risk exposures in relation to appetite and the Society has developed appropriate early warning indicators and escalation procedures to anticipate and respond to 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 requires/provides:

- a sound understanding of internal and external influences on the Society and its principal risks;
- enhanced risk management and complementary stress testing approaches/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:

Increasing Severity

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 Plan	Scenario analysis is used to inform the development of a suite of recovery actions (primarily capital and liquidity) to be used under extreme stress and to set and validate operational protocols.
Reverse Stress Testing	An assessment of the stress scenarios under which the Society would potentially become unviable. This examines potential weaknesses in the Society's business model under extreme events so that mitigating actions can be identified (as appropriate).

Risk assessment and management

The Society operates defined risk assessment and management processes to facilitate the consistent identification, analysis, evaluation and response to risks across the Society. The framework can be applied for both strategic and operational risk assessments and is set within the Society's business environment and its strategy and objectives. A summary of the five stages of this process is set out below:

Risk identification – the Society operates an enterprise 'top down' and operational 'bottom up' risk identification processes to capture new or emerging risks, which could impact corporate objectives and the delivery of the Society's strategy.

Risk analysis – the Society utilises a range of methodologies to assess risks identified in order to understand their severity and likelihood on the delivery of the Society's strategy and to inform risk evaluation and treatment.

Risk evaluation – the Society evaluates and prioritises risks to inform decision making on risk mitigation and to optimise the allocation of resources.

Risk treatment – management selects and deploys appropriate risk responses, balancing the potential benefit derived versus economic cost, effort and implications for key stakeholders.

Monitoring and review – the Society monitors its risk assessment and management processes to proactively identify and adjust to changes in risk profile and to understand the effectiveness of implementing risk treatment strategies.

Risk reporting

The Society operates an appropriate risk reporting hierarchy to provide the right information, to the right people, at the right time, to inform and support timely decision making. The Society uses a combination of strategic and business process reporting to understand the current or potential risk profile of the business, which may impact the delivery of its strategy and corporate objectives. These reporting processes are conducted at an appropriate frequency and are co-ordinated by the Risk Function.

Board Risk Committee Review

Constitution and frequency

The committee consists of four independent non executive directors: David Fisher (Chair), Phil Jenks, John Hunt and Gareth Hoskin. All members have strong backgrounds within banking and financial services. Full biographies of committee members can be found on pages 45 to 47.

During the year, the committee held eight meetings. At the invitation of the committee, meetings were attended by the executive team 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.

Board Risk Committee Report

Year ended
31 December 2018

Continued

BRC responsibilities and 2018 focus areas

The BRC had a full agenda during 2018, which involved balancing oversight over the current risk profile of the Society with emerging risks and requirements. In addition, BRC also became responsible for the oversight of the Models and Rating System Committee (MRSC), following a review of governance arrangements. MRSC has retained responsibility as the designated committee for the IRB rating system. The main responsibilities of BRC and the 2018 focus areas are outlined below:

Responsibilities of the BRC
• Oversee the development, implementation and effectiveness of the ERMF.
• 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 emerging risks.
• 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, Recovery Plan).
• Ensure that the Society's remuneration arrangements reflect appropriate risk considerations.
• Oversee the activities of Executive Risk Committees.
The full BRC ToR is available from the Corporate Governance section of the Society's website.

2018 Focus Areas	
Topic	**Activity**
Frameworks and Policies	• Annual review and approval of the ERMF; 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 Recovery Plan to the Board; • Annual review and recommendation of the Recovery 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 Strategy; • Annual review of Financial Crime Strategy; • Review of Product/Credit Strategy following IRB approval; and • Review of the approach to operational resilience.
Models	• Review of model governance; and • Review of pricing models and methodologies.
Monitoring of Risk Profile	• Risk exposures in relation to appetite (through MI); • External risk assessment via the CRO report and Strategic Heat Map; • Review of annual Money Laundering Reporting Officer report; • Review of cyber penetration testing results; • Thematic deep dive reviews; • Review of significant incidents; and • Oversight of Executive Risk Committees.

Effectiveness review

During October, 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 ToR.

Outlook

It is anticipated that 2019 will be another busy year for the BRC in light of the emerging risk environment and the introduction of new regulatory requirements. However, I believe that the committee remains well positioned to meet these challenges, as well as supporting the Society in the delivery of its strategy.

David Fisher
Chair of Board Risk Committee
26 February 2019

Audit Committee Report

Year ended
31 December 2018

Dear member,

I am pleased to present the report on the work of the Audit Committee during 2018. The committee's main areas of responsibility are in respect of the Society's internal control environment and its external financial reporting. Of particular note this year were the continued development of integrated assurance over the risk and control environment, an external quality review of the Internal Audit Function and the implementation of IFRS 9.

The committee has continued to receive appropriate assurance over the risk and control environment of the Society (both throughout the year and as part of the annual attestation process). This concluded that the control environment remains effective and proportionate to the Society's operations. During the year, the benefits of the recently implemented risk management software have been seen, resulting in a more integrated approach to the management and reporting of risks and controls across all three lines of defence. This has driven an improvement in the quality of reporting to the committee, allowing greater focus on the key matters for consideration.

The Internal Audit Function continues to provide an effective and independent third line of defence. The external quality review, undertaken by KPMG during the year, showed the function to be fully compliant with all regulatory standards. The committee also satisfied itself that the external auditor remains effective and independent.

The Society adopted IFRS 9 from 1 January 2018, following a multi-year project overseen by the committee. A significant amount of time has been devoted to understanding and confirming the impact of adoption reported by management and monitoring the embedding of IFRS 9 processes and controls.

In 2019, the committee expects to see continued enhancements to the assurance received over internal controls, with a particular focus on critical controls.

Purpose and constitution

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

- review the adequacy and effectiveness of the Society's systems of internal control and risk management;
- monitor the effectiveness, performance and independence of the Internal Audit Function;
- 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;
- 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. The other members of the committee throughout 2018 were Les Platts, David Fisher and Lynn McManus. Les Platts retired from the committee, and the Board, on 31 December 2018. Iain Cornish joined the committee in January 2019, following his appointment to the Board. Full biographies of the committee members can be found on pages 45 to 47.

During the year, the committee held six meetings. At the invitation of the committee, meetings were attended by the Chairman, CEO, Deputy CEO, 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 the external auditor and the Chief Internal Auditor, which were not attended by management.

Committee's main activities

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 an Enterprise Risk Management Framework (ERMF) that encourages a culture of sound risk management and internal control. This is overseen by Board Risk Committee and

Audit Committee Report

Continued

delivered through established governance mechanisms and a three lines of defence assurance model. Further details on the Society's ERMF can be found on page 66.

The Society implemented new risk management software across the business towards the end of 2017. During 2018, this has been embedded and enabled a consistent approach to risk and control monitoring and reporting across the Society, supporting improved aggregated risk and control reporting across all three lines of defence.

During the year, the Audit Committee sought and received controls assurance from first line business attestations, second line aggregate reporting, Internal Audit reports and feedback 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, which documents the implementation and effectiveness of key controls, noting any material deficiencies when compared to key risks recorded in the risk register. Where deficiencies arise, management identifies and records remediation activities, which are then 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.

Second line: Risk Function
In addition to second line RCSA returns and risk based monitoring plans, the Risk Function provides an integrated enterprise wide view of risks and controls to the Audit Committee. The reports, including the outcome of the 2018 RCSA exercises, showed control effectiveness within appetite, with remediation activities in place for controls not considered effective. The reporting highlighted a more robust process for the allocation and tracking of remedial activities using the new software.

Third line: Internal Audit Function
Internal Audit's work is designed to provide an independent risk based assessment of the internal control environment. During the year the committee received regular reports from the Chief Internal Auditor containing updates on progress against the agreed plan of work, as well as a summary of findings from each review undertaken and information on the resolution of recommended actions to improve controls. The committee also directed Internal Audit to undertake work on areas of particular importance and interest in addition to those identified through risk assessment, including requesting additional follow up procedures on cyber security and treasury key controls.

Internal Audit tracked and followed up recommendations made in its reviews. In 2018 additional reporting was provided to the committee regarding a small number of areas in which controls implemented in response to higher priority recommendations had not been maintained appropriately. The committee received regular updates from management and Internal Audit until these matters were resolved. Internal Audit has extended its control testing to include a further post-implementation review of all higher priority actions after twelve months, to ensure they are embedded.

The Chief Internal Auditor's annual report to the committee in January 2019 summarised the 2018 audit findings and focused on the key themes, observations and root causes arising from Internal Audit's work. In particular, the committee noted the comprehensive work by Internal Audit to assess whether reliance may be placed on the second line Compliance Monitoring Function, as part of an integrated assurance approach. After detailed consideration during 2018, the committee agreed that Internal Audit could incorporate this reliance into its planning methodology, subject to regular reviews to ensure the conclusions remain valid.

The report also mapped audit findings against the principal risks of the Society, identified by management and recorded in the risk registers. This confirmed appropriate audit coverage. The 2018 Annual Report concluded that the Internal Audit Function had not identified any issues that it considers would materially impact the accuracy and completeness of the financial statements.

External audit
In addition to their comments on the financial reporting assumptions, estimates and judgements, the external auditor 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 2017 or 2018 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 Chair of the Audit Committee.

The committee observed the continued progress and innovation from Internal Audit. During the year the Audit Committee:

- received, assessed and approved Internal Audit's 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;
- noted key innovations in the Internal Audit methodology, including the approach to auditing business change and enhancements in use of data for audit purposes;
- 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; 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.

In addition to the regular self-assessments undertaken by Internal Audit, the Audit Committee is required to commission an external quality assessment of the Internal Audit Function every three to five years. The most recent review occurred in 2015; however, the Chief Internal Auditor proposed a review in 2018 given the importance of Internal Audit to the Society and industry developments, including the 2017 updates to the Financial Services Code. KPMG LLP was appointed to perform the 2018 review and reported its findings to the Audit Committee in January 2019.

The report concluded that the Internal Audit Function is fully compliant with all sections and subsections of the Chartered Institute of Internal Auditors' Standards and the Financial Services Code. Where areas for potential improvement were identified, an action plan has been put in place to address these in 2019.

Based on its work throughout the year and the results of the external quality assessment, the Audit Committee is pleased to note that the Society's Internal Audit Function is independent, effective and compliant with applicable standards. The committee concluded that the work completed by the Internal Audit Function in 2018 has provided adequate coverage across the principal risks of the Society.

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 accounts 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 this work during the year is set out below.

Year ended
31 December 2018

Continued

Area of focus	Reporting issue	Action taken by the Audit Committee	Conclusions
Residential impairment loss provisions	The adoption of IFRS 9, with effect from 1 January 2018, has resulted in significant changes to the calculation of impairment loss provisions in comparison to previous years. Impairment loss provisions are calculated using complex statistical models which incorporate historical default and loss experience information. The provision required under IFRS 9 depends on whether a significant increase in credit risk has occurred since origination, the determination of which requires significant management judgement. Provisions also incorporate forward looking economic scenarios which require estimation by management.	Oversaw the multi-year project for the implementation of IFRS 9. Reviewed and challenged reports from management on the basis of the calculation of the impairment loss provisions and the management judgements and estimates applied. Noted the analysis provided by management in relation to the sensitivity of model outputs to changes in assumptions. Scrutinised the post model adjustments made by management to incorporate additional factors into provisions which are not covered by models. Considered the outcome of the detailed discussions and challenges to management by the Credit Committee. The Chair and other members of the Audit Committee attended Credit Committee discussions on impairment. Noted the challenge from the external auditor relating to the selection and weighting of economic scenarios, also noting that the Society's approach is in line with its peers. Considered whether movements in provisions were consistent with changes in economic conditions, in particular, whether management had sufficiently considered the potential impacts of the UK's departure from the EU and the uncertainty around those impacts. Requested benchmarking information from the external auditor in respect of other financial institutions' adoption of IFRS 9 and approach to economic assumptions and the UK's departure from the EU.	Following consideration of this information, the committee concurred with the Credit Committee's view that the reported initial impact of the adoption of IFRS 9 was appropriate. The committee agreed that management's approach to deriving economic scenarios and probability weightings is reasonable; also that the approach to incorporating the potential impacts of the UK's departure from the EU into provisioning assumptions is appropriate. Therefore the committee agreed that the level of impairment provisions at the date of the Statement of Financial Position, including post model adjustments, is reasonable.

Area of focus	Reporting issue	Action taken by the Audit Committee	Conclusions
Hedge accounting	The Society holds derivative financial instruments in order to mitigate various business risks, including interest rate and foreign exchange risks. Derivatives are measured at fair value through profit or loss, so changes in the value of these instruments are recognised in the Income Statement immediately. However, if strict accounting criteria are met, some/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 hedge accounting rules of IAS 39. Requested that additional assurance work be performed during the year by the external auditor in relation to hedge accounting processes and controls, including derivative valuation. Reviewed and challenged reports from management on hedge accounting methodologies and the Income Statement impacts. Noted the results of the external auditor's detailed substantive testing and re-performance of hedge effectiveness testing.	The committee has satisfied itself that the results of hedge effectiveness testing performed throughout the year are materially appropriate. The committee concluded 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 the classification and measurement requirements of IFRS 9. As well as derivatives (as noted above), this includes some 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 and challenged management's conclusions as to the application of the classification and measurement criteria of IFRS 9. Reviewed the derivative valuation process alongside the hedge accounting work as set out above. Sought explanation from management to understand the reported movements in fair values. Reviewed management's methodologies 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. Challenged the macroeconomic assumptions used by management in calculating the impact on the fair value of the collateral loan of the no negative equity guarantee on the underlying mortgages. Considered the results of modelling performed by the external auditor of the values of complex derivatives and the collateral loan.	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 is determined based on a number of unobservable and judgemental inputs as open market prices are not readily available. The committee concluded that, considering the alternative modelling provided by management and the external auditor, 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 2018

Continued

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 surplus/obligation	The Society has a defined benefit pension scheme, which was closed to new entrants in January 2000 and 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 the scheme's actuary, KPMG. Noted confirmation from management that these assumptions, together with the disclosures in the Annual Report and Accounts, were consistent with IAS 19. Reviewed reports from management on the impacts of the court ruling on Guaranteed Minimum Pensions (GMP) equalisation.	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, the recognition on the balance sheet of the pension scheme surplus and the treatment of the impacts of GMP equalisation.
Provisions for liabilities and charges	The Society has set aside provisions for liabilities and charges including for the potential cost of customer redress, such as mortgage payment protection insurance (MPPI). Although as far as possible the level of these provisions is evidence based, there is a degree of management judgement and estimation required to determine the appropriate level of provisions.	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. For MPPI provisions, considered the impact of the upcoming deadline for claims in August 2019.	The committee concluded that the overall level of provisions was appropriate.
Recognition and measurement of intangible assets	During the year, the Society continued its strategic investment in technological functionality. Judgement is required in assessing whether the expenditure meets the requirements of IAS 38 in order to be capitalised as an intangible asset, or whether it should be accounted for as an expense. In addition, capitalised amounts should be regularly assessed for impairment to determine whether they remain supportable in light of the future benefits to be realised.	Received management's report setting out the costs which were proposed for capitalisation and the rationale supporting this conclusion. Considered management's assessment of impairment in light of other information provided to the committee.	The committee agreed with the capitalisation of certain elements of expenditure. 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.

Area of focus	Reporting issue	Action taken by the Audit Committee	Conclusions
Going concern assessment and Viability Statement	The directors are required to prepare the financial statements on a going concern basis, unless they consider that it is inappropriate to presume that the Society will continue in business for the next 12 months. The Board 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 also 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 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 2018 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. The committee 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.

Independence, performance and objectivity of the external auditor

During 2018, in undertaking its oversight of the relationship with the external auditor and their effectiveness in the external audit process, 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 assessment of significant judgements and risks and considering the effect of industry developments 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, 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 2017/18 cycle, published in June 2018; and
- held two private meetings to discuss any issues and concerns arising from the auditor's work.

The committee also reviewed and approved the policy on non audit services, including the employment of former partners or staff of the external auditor, considering the requirements of the 2016 version of 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 2018, non audit fees, including one-off items, represented 33% of the annual audit fee.

The committee satisfied itself that the external auditor is effective and independent.

Other matters addressed by the committee

Changes to accounting standards

As reported above, IFRS 9 became effective from 1 January 2018, changing how the Society accounts for its financial instruments. Following adoption, the IFRS 9 implementation project was closed. The committee retains responsibility for overseeing the ongoing application of IFRS 9 in the financial statements of the Society, so has sought assurance from management that the agreed governance arrangements have operated effectively throughout the year.

The Society adopted IFRS 16 – Leases with effect from 1 January 2019. Ahead of adoption, the committee received reports from management regarding the key decisions made plus the anticipated impact and is satisfied that the approach adopted by management is appropriate.

Speak Up Policy

During 2018, the committee was 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.

From 1 January 2019, the Speak Up Policy will be a matter reserved for the Board, as required by the 2018 changes to the Corporate Governance Code.

Other reporting matters

The committee reviewed and approved the Society's Tax Strategy. The committee approved the Tax Risk Management Policy, as well as the Financial Reporting and Disclosure Policy.

The committee reviewed the 2018 Pillar 3 disclosures and recommended the document for approval by the Board.

Audit Committee effectiveness and training

The committee undertakes an annual 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 (ToR) and no significant areas for remedial action were noted. 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 ToR 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 ToR were approved at the meeting in November 2018.

All committee members were required to undertake relevant training as part of their overall development during the year. Committee members also received training from both internal and external sources. In 2018, training for the committee included financial reporting and corporate governance updates.

Finally, I would like to express my thanks to Les Platts for his hard work, expertise and dedication to the committee prior to his retirement at the end of the year and welcome Iain Cornish to the committee for 2019.

Gareth Hoskin
Chair of Audit Committee

26 February 2019

Directors' Remuneration Report

Year ended
31 December 2018

Annual Statement

Dear member

I was appointed Chair of the Remuneration Committee (subject to regulatory approval) in January 2019 and, as such, I am pleased to present the 2018 Directors' Remuneration Report. This includes details of our annual report on remuneration for our executive directors, non executive directors and Material Risk Takers.

The report is presented in two sections:

- The Remuneration Policy (pages 82 to 87) explains how we pay executive directors, non executive directors and Material Risk Takers. No changes have been made since it was approved by members at the AGM in April 2018.
- The Annual Report on Remuneration (pages 88 to 94) explains how we put our existing policy into practice in 2018 and how we intend to implement this policy in 2019.

Members will have the opportunity to vote, on an advisory basis, on the Directors' Remuneration Report, at the AGM.

Approach

The Directors' Remuneration Report is produced in compliance with the FCA dual regulated firms Remuneration Code.

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 ensure we are able to attract and retain the appropriate talent to deliver our goals. We seek 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.

The Board sets the Society's strategy, designed to ensure we have a prosperous, sustainable business, focused on meeting our members' needs. For 2018, the Board set six corporate priorities for executive directors, related to customer satisfaction, broker satisfaction, sustainable growth, colleague engagement, cost management and profit.

The Remuneration Committee has considered the performance of the Society and the executive directors in detail, taking into account the balance of performance. A breakdown of the outturn of the corporate and personal objectives is provided on page 91.

Performance and awards

Earlier sections of the Annual Report and Accounts have explained we have delivered a strong financial performance. We have also achieved material de-risking of our legacy portfolios, made good progress with our customer experience agenda, achieved a 2* Best Companies accreditation and are progressing with the implementation of our long term strategy.

As a result, annual bonuses of between 41.5% and 44.9% have been awarded to the executive directors, which represents between 82.9% and 89.7% of the maximum award available.

In arriving at the decision to award variable remuneration, 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. Very careful consideration was given to the risk assessment process and the process determined that the Remuneration Committee should assess whether an adjustment was required. Following full consideration, no adjustment was applied.

Executive director changes

Our Chief Executive Officer, Peter Hill, leaves in February 2019 after over 16 years with the Society, serving over seven years as Chief Executive Officer. Peter has made a significant contribution to our success and I wish him well for the future.

Peter Hill will not participate in the 2019 bonus scheme. Peter's 2018 bonus award will be deferred over a period of seven years, with no vesting until three years after the award is made, with 50% delivered in a share-like instrument. An independent assessment will take 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.

I am delighted that Richard Fearon, currently Deputy Chief Executive Officer, has been appointed as Chief Executive Officer with effect from 27 February 2019.

2018 salary increases

In April 2018, following external benchmarking and as reported last year, the Remuneration Committee 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 increased by 2.4%, as did the Chairman's fee. The basic salary increase for other colleagues ranged from 0% to 5%, with an average of 2.57%.

An increase of 19.8% was awarded to Richard Fearon in August 2018, to reflect his promotion to Deputy Chief Executive Officer. Richard will be appointed to the position of Chief Executive Officer on 27 February 2019. Richard will receive a base salary of £450,000 from the date of his appointment.

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 2018 was 3.88%.

Other matters considered by the Remuneration Committee

In 2018, the committee consisted of four other non executive director members: Les Platts, the previous Chair, David Fisher, Philippa Brown, and Gareth Hoskin. The Chairman, Chief Executive Officer and other senior managers are invited to attend meetings as appropriate, but are not members. Our Director of People, Becky Hewitt, is the Committee Secretary. The committee receives appropriate training sessions throughout the year.

There were four meetings in 2018, 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.

The committee also provided oversight to management's proposals for pension savings arrangements for colleagues, due to changes in statutory pension contribution rates. These were supported by the Board and by colleagues following a formal consultation process. A new, simplified contribution structure is being introduced for colleagues joining the Society from April 2019. The pension arrangements for existing executive directors remain unchanged. However, any new executive directors will be enrolled in the colleague scheme.

Looking ahead

Looking ahead to 2019, the committee's focus will be on ensuring we have the right reward structures in place to support our future priorities and attract and retain the talent we will need to deliver our objectives. While the structure of the variable remuneration schemes for 2019 will remain unchanged, a review is to take place this year for the 2020 schemes.

I have been appointed as the non executive director responsible for representing colleague views to the Board and, as such, will engage with colleagues during the year on reward, as well as other employment topics and will report on this next year.

Summary

I trust you will find this report helpful and informative. The Remuneration Committee recommends that members vote in favour of the 2018 Directors' Remuneration Report at the AGM.

Lynn McManus
Chair of the Remuneration Committee
(subject to regulatory approval)

26 February 2019

Directors' Remuneration Report

Continued

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, whilst not encouraging risk taking that exceeds the level tolerated by the Society;
- Basic salary and total remuneration are 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 2018 AGM.

Annual General Meeting 2018 results

Resolution	% votes for	% votes against
Directors' Remuneration Report	89.79%	10.21%
Directors' Remuneration Policy	88.99%	11.01%

Components of remuneration

The following table summarises the principal components of the executive directors' total remuneration and the way they operate. Details which are commercially sensitive have not been provided, but performance against target 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 our 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 the executive director 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 Manager 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 Manager 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 2018 **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 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 (e.g. 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 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.

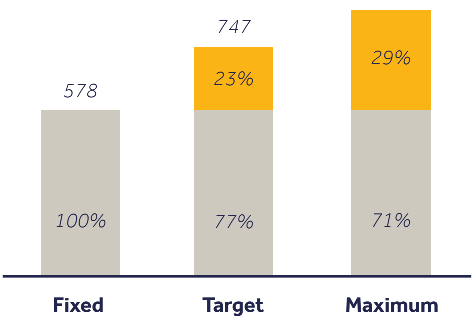
Policy for non executive directors

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 tax liability arises, this will be covered by the Society.		

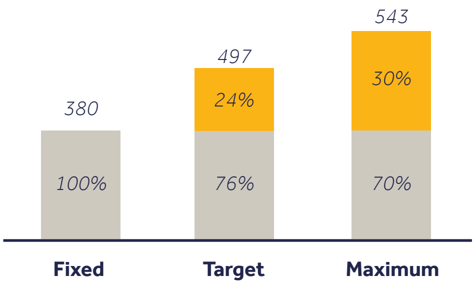
Awards under different scenarios

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

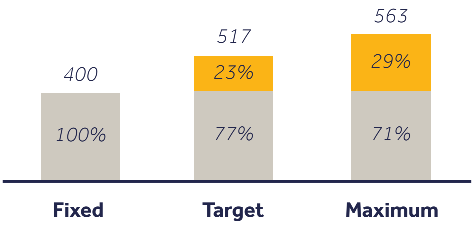
Chief Executive Officer £'000s



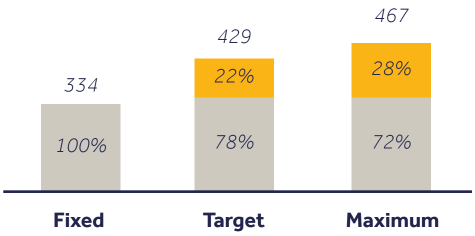
Deputy Chief Executive Officer £'000s



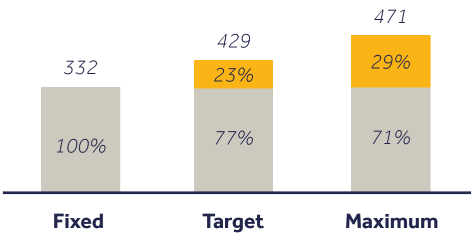
Chief Financial Officer £'000s



Chief Operating 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 31 December 2018

Executive director	Basic salary	Pension	Total fixed
Chief Executive Officer	470	108	578
Deputy Chief Executive Officer	325	55	380
Chief Financial Officer	325	75	400
Chief Operating Officer	265	69	334
Chief Risk Officer	277	55	332

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 2018 **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 hold any paid external directorships.

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

Policy on payment for loss of office

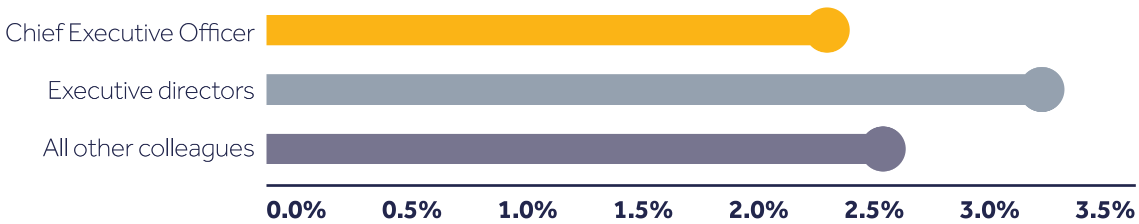
Component	Policy
General	When determining any loss of office payment for a departing individual, the committee will seek to minimise costs to the Society whilst seeking to reflect the circumstances in place at the time. Accordingly, the committee retains overriding judgement to make loss of office payments 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 2018, following external benchmarking and as reported last year, the Remuneration Committee 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 the other executive directors increased by 2.4%.

The table below illustrates the comparison of average base salary increases made in April 2018 to the Chief Executive Officer, executive directors and all other colleagues:



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.

The executive directors' salaries from 1 January 2019 are as follows, compared with 2018:

	1 January 2019	1 January 2018
P A Hill	£470,020	£459,000
R G Fearon	£325,000	£265,000
R S P Litten	£325,000	£307,000
K R Wint	£265,220	£259,000
A J Greenwood	£277,110	£270,606

An increase of 19.8% was awarded to Richard Fearon in August 2018, to reflect his promotion to Deputy Chief Executive Officer. Richard will be appointed to the position of Chief Executive Officer on 27 February 2019. Richard will receive a base salary of £450,000 from the date of his appointment.

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 2019	Increase
R G Fearon	£450,000	0%
R S P Litten	£332,320	2.25%
K R Wint	£271,190	2.25%
A J Greenwood	£286,120	3.25%

Continued

Annual Report on Remuneration

Total remuneration summary

The total remuneration received by executive directors for 2018 is detailed below, compared with 2017. The total remuneration for executive directors equates to 2.3% of profit before tax (2017: 2.1%). This information has been audited and shows remuneration for the years ending 31 December 2017 and 31 December 2018, as required to be reported under the Building Societies (Accounts and Related Provisions) Regulations 1998. The awards made in respect of performance in 2018 are in line with the 2018 Remuneration Policy, with a maximum variable pay of 50% for executive directors.

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.

2018 audited

Executive directors	Salary	Annual bonus	Pension	Loss of office	Total remuneration
	£'000	£'000	£'000	£'000	**£'000**
P A Hill	467	211	107[1]	–	**785**
R G Fearon	292	146	50[1]	–	**488**
R S P Litten	320	142	74[1]	–	**536**
K R Wint	264	112	63[1]	–	**439**
A J Greenwood	275	115	55[1]	–	**445**
Total remuneration[2]	**1,618[3]**	**726[3]**	**349**	**–**	**2,693**

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 G Fearon	238	158	39[1]	–	**435**
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**
Total remuneration[2]	**1,407[3]**	**864[3]**	**284**	**–**	**2,565**

Notes
(1) These directors elected to receive part or all of the Society's pension contribution as a cash allowance.
(2) No director received other taxable benefits of £1,000 or above.
(3) On 1 January 2018, a salary adjustment was applied to rebalance variable and fixed remuneration. The salary adjustments reflect a reduction in the maximum bonus achievement from 75% to 50%.

Unpaid deferred elements of the annual bonus scheme

Executive directors	Performance year	Due 2019 £'000	Due 2020 £'000	Due 2021 £'000	Due 2022 £'000	Due 2023 £'000	Due 2024 £'000	Due 2025 £'000	Due 2026 £'000	Due 2027 £'000	Total £'000
P A Hill	2015	30	–	–	–	–	–	–	–	–	30
	2016	34	33	–	–	–	–	–	–	–	67
	2017	35	35	36	–	–	–	–	–	–	106
	2018	**42**	**42**	**–**	**13**	**25**	**25**	**25**	**25**	**14**	**211**
	Total	**141**	**110**	**36**	**13**	**25**	**25**	**25**	**25**	**14**	**414**
R S P Litten	2015	21	–	–	–	–	–	–	–	–	21
	2016	22	23	–	–	–	–	–	–	–	45
	2017	23	23	24	–	–	–	–	–	–	70
	2018	**28**	**28**	**–**	**9**	**17**	**17**	**17**	**17**	**9**	**142**
	Total	**94**	**74**	**24**	**9**	**17**	**17**	**17**	**17**	**9**	**278**
K L Rebecchi	2015	8	–	–	–	–	–	–	–	–	8
	2016	–	–	–	–	–	–	–	–	–	–
	2017	–	–	–	–	–	–	–	–	–	–
	2018	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**
	Total	**8**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**8**
K R Wint	2015	17	–	–	–	–	–	–	–	–	17
	2016	17	18	–	–	–	–	–	–	–	35
	2017	19	20	20	–	–	–	–	–	–	59
	2018	**67**	**15**	**15**	**15**	**–**	**–**	**–**	**–**	**–**	**112**
	Total	**120**	**53**	**35**	**15**	**–**	**–**	**–**	**–**	**–**	**223**
A J Greenwood	2015	12	–	–	–	–	–	–	–	–	12
	2016	13	13	–	–	–	–	–	–	–	26
	2017	15	16	16	–	–	–	–	–	–	47
	2018	**69**	**15**	**15**	**16**	**–**	**–**	**–**	**–**	**–**	**115**
	Total	**109**	**44**	**31**	**16**	**–**	**–**	**–**	**–**	**–**	**200**
R G Fearon	2016	16	16	–	–	–	–	–	–	–	32
	2017	21	21	21	–	–	–	–	–	–	63
	2018	**87**	**19**	**20**	**20**	**–**	**–**	**–**	**–**	**–**	**146**
	Total	**124**	**56**	**41**	**20**	**–**	**–**	**–**	**–**	**–**	**241**
Total		**596**	**337**	**167**	**73**	**42**	**42**	**42**	**42**	**23**	**1,364**

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

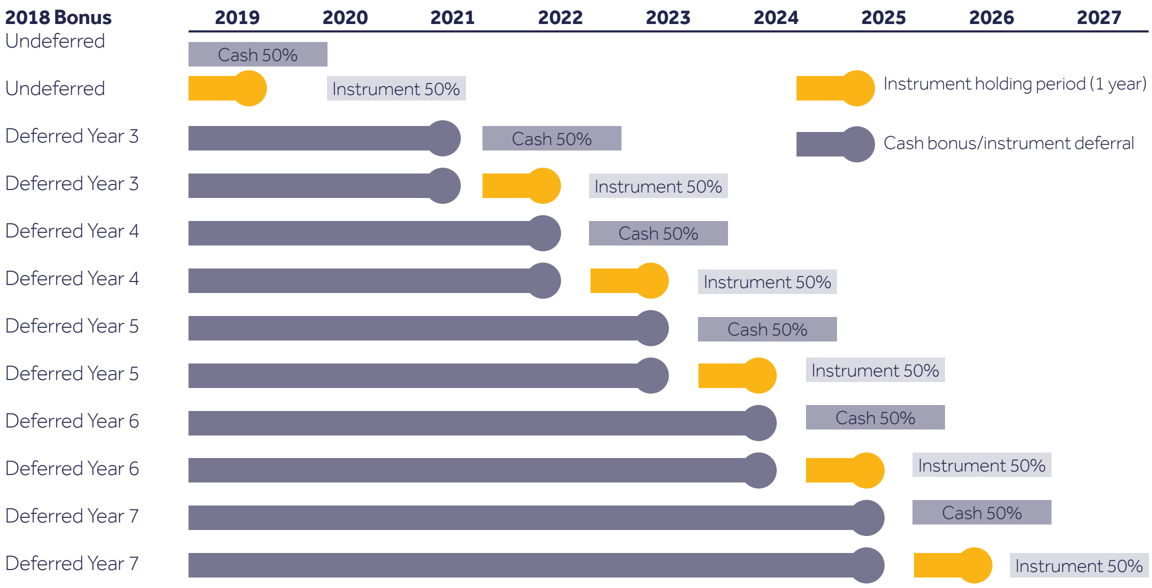
Bonus deferral and share-like instrument

For executive directors designated as 'Senior Managers' under the Senior Manager Regime and over the de-minimis limit, 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.

For executive directors designated as 'Senior Managers' under the Senior Manager Regime and below the de-minimis limit, 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.

Continued

The table below illustrates how the 2018 bonus for the Chief Executive Officer and Chief Financial Officer will be delivered:



Risk assessment

The risk assessment process is independently managed by the Risk Function. Following completion of the risk assessment process, the Chief Risk Officer (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 2018 report in full and determined the Remuneration Committee should assess whether an adjustment was required. Following full consideration, no adjustment was applied.

Performance outcomes against targets for incentive awards

The 2018 scheme has generated awards of between 41.5% and 44.9% (2017: 42.7% and 66.1%) of salary for executive directors, reflecting between 83% and 90% (2017: 84% and 88%) of the maximum award available.

The 2018 scheme provides for:

- financial performance measures (max. 17% opportunity, with 5% of this for superior performance);
- corporate performance measures (max. 17% opportunity, with 5% of this for superior performance); and
- personal performance measures (max. 16% opportunity, with 4% 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 2018, 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 10.8% to 41.47% (in respect of the CRO).

Vision: strategic pillar	**Corporate performance measure**	Weightings for maximum (as % of salary)	Target	Actual	Pay out %
Secure	Profit before tax	17%	£119.3 million	£116.9 million(2)	17%
Customer focused	Sustainable growth	3.4%	£1.2 to £1.5 billion net lending with gross lending delivering 71 basis points simple value	£1.0 billion net lending; 72 basis points simple value	2.2%
	Expert lender	3.4%	31% UPWTR(1) totalled across mainstream and buy to let, with neither individual component more than 2% below 2017 average performance	Total UPWTR was 30%. Mainstream and buy to let were both 15% compared to 2017 performances of 17% and 12% respectively	2.3%
Service driven	Delivering outstanding service to all our members	3.4%	Leeds Building Society Customer Experience Indicator (CEI) annual average 8.50 and Nunwood Customer Experience Excellence score of 7.32	Our internal CEI score was 8.51 and our Nunwood score was 7.55	3.4%
	Engaged workforce	3.4%	2* Best Companies accreditation	We achieved a 2* accreditation with our best ever score	3.4%
Efficient	Efficiency	3.4%	Cost : income ratio of 44.3% and 2018 management expenses not to exceed £97.8 million	Cost : income ratio 44.8%(2); management expenses £98.9 million(2)	3%

(1) Unprompted willingness to recommend.

(2) The committee considered that the loss on the sale of Irish mortgages and certain one-off management expenses should be excluded from the measurement of performance.

Notes

The financial and corporate measures only apply to the Chief Executive Officer, Deputy Chief Executive Officer, Chief Financial Officer and Chief Operating 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 who 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 2018, there were 28 Material Risk Takers during the year.

Year ended
31 December 2018

Continued

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	
	2017	2018	2017 £'000	2018 £'000	2017 £'000	2018 £'000	2017 £'000	2018 £'000
Senior management	28	28	4,464	4,937	1,391	1,618	5,855	6,555
Other MRTs	–	–	–	–	–	–	–	–
Total	28	28	4,464	4,937	1,391	1,618	5,855	6,555

Notes
(1) Non executive directors' fees are included under fixed pay and they do not receive variable pay.
(2) £930,000 of variable pay is deferred for one, three, or seven years (2017: £791,000).
(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. 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 £24,498 has been made in 2018 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.

Payments for loss of office

On 26 June 2018, Peter Hill advised the Board of his intention to step down from the Board and his role of Chief Executive Officer on 26 February 2019. All payments made to Peter in respect of his service during 2018 are reported in the single figure in the remuneration table.

Peter will remain employed until 30 June 2019, during which time he is available to the Society on a consultancy basis. Peter has elected not to receive a bonus for the 2019 performance year.

In line with the Remuneration Policy and the bonus scheme rules, the committee agreed to allow the deferred elements of Peter's variable pay award to be paid. These payments will be subject to continued performance adjustment requirements and payments will be made on the normal dates. Regulatory requirements relating to risk adjustments, malus and clawback will continue to apply to all deferred bonus awards.

All payments made in respect to Peter's leaving arrangements are in line with the Remuneration Policy.

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 their respective roles.

Non executive directors	**Basic fees (£'000s)**		**Benefits[1] (£'000s)**		**Committee chair fees (£'000s)**		**Total (£'000s)**	
	2017	2018	2017	2018	2017	2018	2017	2018
R J Ashton (Chairman)	143	147	7	5	–	–	150	152
L M Platts (Vice Chairman)	63	65	2	4	–	–	65	69
P A Brown	47	48	4	2	–	–	51	50
D Fisher	47	48	–	–	16	17	63	65
G Hoskin	47	48	4	6	15	17	66	71
J A Hunt	47	48	3	4	10	3	60	55
P A Jenks	47	48	–	–	–	–	47	48
L R McManus[2]	16	48	1	3	–	–	17	51
S Cooklin[3]	12	–	7	–	–	–	19	–
Total	**469**	**500**	**28**	**24**	**41**	**37**	**538**	**561**

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 was appointed on 1 September 2017.

(3) This director retired on 6 April 2017.

An increase of 2.4% was agreed for the Chairman to £147,637 with effect from 1 April 2018. The fee for the Vice Chairman was increased by 2.4% to £65,331 and the basic non executive director's fee was increased by 2.4% to £48,384. The committee chair fee was increased by 2.4%.

The annual pay review takes place in April, for all colleagues in the Society, including non executive directors. Les Platts left the Society on 31 December 2018 and Gareth Hoskin has been appointed to the role of Vice Chairman from 1 January 2019 (subject to regulatory approval). Lynn McManus is the Chair of the Remuneration Committee from 1 January 2019 (subject to regulatory approval). Following a market review and external benchmarking, fees from 1 April 2019 will be as follows:

Non executive directors	**Basic fees (£'000s)**	**Committee chair fees (£'000s)**	**Total fees (£'000s)**
	2019	2019	2019
R J Ashton (Chairman)	151	–	151
G Hoskin (Vice Chairman)	73	–	73
P A Brown	50	–	50
D Fisher	50	17	67
J A Hunt	50	–	50
P A Jenks	50	–	50
L R McManus	50	11	61
Total	**474**	**28**	**502**

Year ended
31 December 2018

Continued

Directors' loans, transactions and related business activity

The aggregate amount outstanding at 31 December 2018 in respect of loans from the Society or a subsidiary undertaking to directors of the Society or persons associated with directors was £1,054,166 (2017: £1,076,172), being four mortgages (2017: 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.

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
2018	785	89.7
2017	765	87.0
2016	728	84.0
2015	649	86.0
2014[1]	586	79.3

(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 2.4% during 2018. This compares to an average increase of 2.57% 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 2018, compared to the previous year.

	2018	2017	Percentage change
Profit after tax	£89.2m	£88.0m	1.36%
Colleague remuneration costs	£49.0m	£47.4m	3.38%
Headcount	1,401	1,403	(0.14%)

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 2018 were PricewaterhouseCoopers LLP, who in 2018 provided professional advice, guidance and training to the committee. Training was also delivered by Ernst & Young. 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.

Our strong performance over many years has resulted in record retained capital and reserves and we have further consolidated our financial strength. We are very well placed to continue to act in the long term interests of the Society and deliver sustainable growth for the benefit of our members.

Directors' Report

Year ended
31 December 2018

The directors have pleasure in presenting their Annual Report, together with the Annual Accounts and Annual Business Statement, for the year ended 31 December 2018.

Information on the Society's vision, strategy and business performance is provided in the Strategic Report on pages 8 to 10.

Profits and capital

Profit before tax for the year was £116.9 million (2017: £120.9 million). The profit and capital position is set out further on pages 24 to 31 of the Strategic Report.

Principal risks and uncertainties

The Society's approach to managing risks is set out in the Board Risk Committee Report on pages 66 to 70. The principal risks and uncertainties faced by the Society are set out in the Strategic Report on pages 14 to 21. Further information relating to the Society's financial risks and the approach to management of those risks is included in notes 31 to 34 of the Accounts.

Corporate governance

Statements on corporate governance and directors' roles and responsibilities are set out in the Corporate Governance Report on pages 48 to 61.

Colleagues

Information on key colleague policies and associated key performance indicators are included in the Strategic Report on pages 32 to 33.

Environmental policy

The Society's approach to the environment is summarised in the Corporate Responsibility section of the Strategic Report on pages 34 to 43.

Charitable and political donations

In 2018 the Group made a donation of £90,000 (2017: £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 £85,000 (2017: £45,000).

The Caring Saver Account and the Your Interest In Theirs scheme provided further donations of £16,000 (2017: £18,000) and £100,000 (2017: £107,500) respectively to specified charities.

Other charitable contributions from colleagues and members totalled £80,000 (2017: £67,000) taking total donations to charity and good causes to £371,000 (2017: £327,500). No political donations were made during the year (2017: £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 12 days at 31 December 2018 (2017: seven days).

Mortgage arrears

At 31 December 2018, there were 112 (2017: 201) mortgage accounts 12 months or more in arrears. The total mortgage arrears, for these cases, was £1.5 million (2017: £3.5 million) and the total principal balance outstanding was £12.9 million (2017: £34.5 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 statements on the respective responsibilities of directors and auditor on pages 104 and 105.

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 that they 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 an Annual Business Statement and a Directors' Report for each financial year. Each contains 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.

The directors who held office at the date of approval of this report confirm that, as far as they are aware, there is no relevant information of which the Society's auditor is unaware and that each director has taken all steps necessary to make themselves aware of any relevant audit information and establish that the Society's auditor is aware of that information.

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, as well as the potential impact of the principal and emerging risks set out on pages 14 to 21 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. This is explained in the Viability Statement on pages 22 to 23 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, so that the Group is not exposed to losses on these assets which would impact its decision to adopt the going concern basis.
- 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 are sufficient to maintain capital in excess of regulatory requirements, under both central and modelled stressed scenarios.

The directors have therefore concluded that it is appropriate to adopt the going concern basis in preparing the financial statements.

Directors

The names of the directors of the Society, their roles and membership of Board committees are detailed on pages 45 to 47. Additionally, Les Platts was Vice Chairman and Senior Independent Director until his retirement from the Board on 31 December 2018. Annette Barnes and Iain Cornish were appointed to the Board in 2019.

In line with best practice, all executive and non executive directors offer themselves for election or re-election by the members at the AGM, apart from Peter Hill who retires from the Board on 26 February 2019. None of the directors hold 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

26 February 2019

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

Year ended
31 December 2018

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Leeds Building Society (the "Society") and its subsidiaries (the "Group")

- give a true and fair view of the state of the Group's and Society's affairs as at 31 December 2018 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 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 member's interests;
- the Group and Society statements of cash flows; and
- the related notes 1 to 38.

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 Financial Reporting Council's (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: • IFRS 9 Financial Instruments – Expected Credit Loss ("ECL") provisioning; • Hedge accounting; and • 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 are identified with
Materiality	The materiality that we used in the Group financial statements was £6.4m which was determined on the basis of 5.2% of adjusted profit before tax as per the consolidated income statement.
Scoping	All material entities in the Group are within our audit scope and audited to a lower materiality for the purpose of individual entity reporting. Audit work to respond to the risks of material misstatement was performed directly by the Group audit engagement team.
Significant changes in our approach	Our risk assessment process has resulted in the key audit matters reported upon remaining broadly consistent with the previous year, albeit updated for changes in accounting standards. These continue to be areas in which significant judgement and complexity are inherent in the account balance.

Conclusions relating to going concern, principal risks, and viability statement

Going concern

We have reviewed the directors' statement on page 97 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 considered as part of our risk assessment the nature of the Group, its business model and related risks including where relevant the impact of Brexit, the requirements of the applicable financial reporting framework and the system of internal control. We evaluated the directors' assessment of the Group's ability to continue as a going concern, including challenging the underlying data and key assumptions used to make the assessment, and evaluated the directors' plans for future actions in relation to their going concern assessment.

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 21 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 22 that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity;
- the directors' explanation on page 22 as to how they have assessed the prospects of the Group, 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 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.

IFRS 9 Financial Instruments – Expected Credit Loss provisioning

Key audit matter description

IFRS 9 is a new and complex accounting standard which has required considerable judgement and interpretation in its implementation. These judgements have been key in the development of new models which Management has built and implemented to measure the expected credit loss ('ECL') on loans measured at amortised cost.

Estimating these expected losses requires judgement and estimation on assumptions relating to customer default rates, likelihood of repossession, future property values, forced sale discounts and indicators of significant increases in credit risk. These assumptions are informed using historical behaviour and experience as well as credit bureau data.

The Group held £34.2m of impairment provisions against such loans at year-end in accordance with IFRS 9 (2017: £43.5m in accordance with IAS 39) against total loans and advances to customers of £16,074.6m (2017: £15,254.0m). The transition adjustment on adoption of IFRS 9 at 1 January 2018 was an increase of £26.4m (resulting in a total provision of £69.9m). During 2018 the Group sold its Irish Residential mortgage book which resulted in a reduction in gross loan assets of £163.6m and a release of £21.3m from impairment provisions.

The Group applies three macro-economic scenarios when determining the ECL calculation; a central outlook, a downturn scenario and a growth scenario. Probability weightings assigned to each scenario are determined by the Strategy team and approved by Executive Committee (Exco).

The selection and probability weighting of relevant macro-economic scenarios is judgemental and has a significant impact on the ECL calculation.

Our key audit matter has been pinpointed to the risk of Management bias in selecting the probability weightings of macroeconomic assumptions and the level of consistency in approach when determining the probability weightings for each scenario period on period.

Given the material effect of the significant judgements taken by Management in the measurement of the provision, we also considered the potential for fraud through possible manipulation of this balance.

The Group's loan loss provision balances are detailed within note 31. Management's associated accounting policies are detailed on pages 116 to 117 with detail about judgements in applying accounting policies and critical accounting estimates on pages 121 to 122. Management's consideration of the effect of the future economic environment is disclosed on page 121. The audit committees' consideration of the matter is described on page 74.

How the scope of our audit responded to the key audit matter	We first evaluated the design and implementation of controls over the loan impairment provisioning process. This included specific assessment over the level of challenge at key Management review forums. We engaged credit risk and accounting specialists to assess the compliance of the modelling approach with the requirements of the standard. We also engaged IT and credit risk specialists to determine whether the documented modelled approach was implemented in practice. We challenged Management's consideration of the future economic environment by engaging our economic experts to review Management's approach as well as comparing modelled assumptions to publically available data from the Office of National Statistics and comparable peer data. Our procedures included challenging Management as to whether there was sufficient downside risk in their modelled approach given the heightened economic uncertainty, in particular relating to the economic impact of the UK's exit from the European Union, at the balance sheet date. We assessed, using publically available data, whether the combination of Management's modelled downside scenario and post-model adjustment for Brexit appropriately captured credit risk relating to the future economic environment. We assessed the completeness and accuracy of post model adjustments made by Management which reflect the best estimate of losses expected but which may not have been fully observed within the current arrears data. We reconciled each book to the general ledger and substantively tested a sample of loans to assess whether the data used in the provision calculation was complete and accurate.
Key observations	Based on the evidence obtained, we consider that the Group's ECL applied to the UK residential mortgage book is within a reasonable range, albeit we consider it to be on the more conservative end of the range. This is driven by a degree of conservatism in a number of assumptions used and the probability weightings attributed to the scenarios.

Hedge accounting

Key audit matter description	The Group applies fair value macro hedge accounting in order to minimise the volatility of fair value measurement in the Statement of Comprehensive Income. 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 the identification of items de-designated from hedging relationships is not complete and the adjustments are not correctly amortised. We also considered the potential for fraud through possible manipulation of this balance. The net fair value adjustment to the hedged item in the macro hedges at the year-end was an asset of £17.2m (2017: £35.1m). Management has taken the IFRS 9 accounting policy choice to continue to apply IAS 39 accounting with respect to all designated hedge relationships. Management's chosen accounting policies are detailed on page 116. The Audit Committee's consideration of this risk is included on page 75.

Continued

How the scope of our audit responded to the key audit matter	We evaluated the design and tested the implementation 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 have also tested the accuracy and completeness of Management's process for designating instruments and items into the macro hedge to assess whether the fair values are accounted for correctly. 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 Group's micro hedges. We also reviewed the macro hedge effectiveness assessment. 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. 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	From our testing of the designation and de-designation of items into macro hedge relationships we concluded that the overall treatment adopted, and subsequent amortisation of de-designated items, was materially correct. We have identified some areas for control and process improvement and immaterial misstatements which have been communicated to Management.

Fair value of complex financial instruments

Key audit matter description	There are a number of complex financial instruments held at fair value by the Group which are classified as level 3 within the fair value hierarchy (see page 167 for a definition of level 3 measurements), and amount to a net carrying value of £159.1m (2017: £205.7m). These have unobservable inputs within the valuation calculation and are: • a collateral loan, which represents a portfolio of equity release mortgages purchased from a third party; • the Retail Prices Index ("RPI") linked derivative hedging the equity release portfolio; and • the derivatives hedging the Residential Mortgage-Backed Securities ("RMBS") securitisation vehicles. We also considered the potential for fraud through possible manipulation of this balance. The following are the unobservable inputs: • The illiquidity premium, life expectancy, house price index and forced sale discount assumptions associated with the equity release mortgage book, including the no negative equity guarantee component; • The RPI assumptions applied to the RPI linked derivative; and • The prepayment rate of mortgages within the RMBS securitisation vehicles. The Group relies on counterparty valuations to determine the fair value of these instruments and we identified a key audit matter that these could be materially misstated. Management's chosen accounting policies are detailed on page 114 with details about judgements in applying these policies and critical accounting estimates on page 122. The Audit Committee's consideration of this risk is included on page 75.

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 by: • reviewing the analysis provided in Management's judgement paper; • independently determining the expected future cash flows for the collateral loan held by the Group; • determining an appropriate rate to discount the independently determined future cash flows to present value, utilising both internal and external data such as the discount rates, repayment profiles and credit risks associated with the assets; and • testing the appropriateness of the other elements inherent in the valuation of the underlying loan assets, such as no negative equity guarantees provided by the Society to the originator of the underlying loans.
Key observations	The independently recalculated complex derivative contract valuations were found to be materially consistent with the Group's valuations. Based on the evidence obtained, we considered that the Group's valuation methodology for the equity release mortgage portfolio was materially consistent with a range of modelled outcomes.

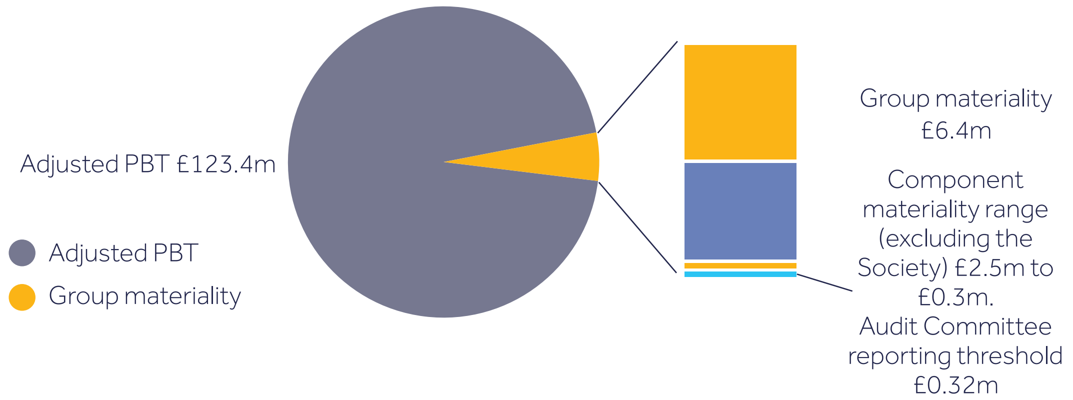
Our application of materiality

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
Group materiality	£6.4m (2017: £6.1m)	£6.2m (2017: £6.0m)
Basis for determining materiality	5.2% of adjusted profit before tax (2017: 5% of income before tax)	5.2% of adjusted profit before tax (2017: 5% of profit before tax)
Rationale for the benchmark applied	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. We have therefore selected profit before tax as the benchmark for determining materiality. An adjusted figure has been used in the year as the sale of the Irish mortgage book resulted in a loss of £6.5m being recognised in the Income Statement. This is not a transaction within the Group's ordinary course of business and therefore it has been removed from the benchmark balance in order to normalise the materiality used in the audit and make it consistent with that of previous years. As the majority of the Group's operations are carried out by the Society, we used the same materiality basis for both.	

Independent Auditor’s Report



We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £320k (2017: £304k) for the Group, 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 £2.5m (2017: £0.03m to £2.4m).

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

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual 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 members 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.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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

Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of Management, internal audit and the audit committee, including obtaining and reviewing supporting documentation, concerning the Group's policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;
- discussing among the engagement team and involving relevant internal specialists, including tax, financial instrument, pensions, and IT regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we identified potential for fraud in the determination of Management's estimates of expected credit loss, fair value of complex financial instruments and hedge accounting; and
- obtaining an understanding of the legal and regulatory frameworks that the group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the group. The key laws and regulations we considered in this context included the Building Societies Act 1986. In addition, we considered the regulation set by the Prudential Regulatory Authority relating to regulatory capital and liquidity requirements which are fundamental to the group's ability to continue as a going concern.

Audit response to risks identified

As a result of performing the above, we identified IFRS 9 Financial Instruments – expected credit loss provisioning, hedge accounting and fair value of complex financial instruments as key audit matters. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

Continued

In addition to the above, our procedures to respond to the risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of Management, the audit committee and in-house legal counsel concerning actual and potential litigation;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with the Prudential Regulation Authority and Financial Conduct Authority; and
- in addressing the risk of fraud through Management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

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 180 for the financial year ended 31 December 2018 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

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 14 years, covering periods from our initial appointment through to the period ending 31 December 2018.

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).

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.

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

Leeds, United Kingdom
26 February 2019

Income Statements

For the year ended
31 December 2018

	Notes	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Interest receivable and similar income	3	**457.0**	413.2	**450.5**	402.7
Interest payable and similar charges	4	**(238.9)**	(200.0)	**(232.3)**	(188.7)
Net interest receivable		**218.1**	213.2	**218.2**	214.0
Fees and commissions receivable		**8.6**	8.7	**8.6**	6.9
Fees and commissions payable		**(0.8)**	(0.5)	**(0.4)**	(0.3)
Fair value gains less losses from financial instruments	5	**(5.7)**	(1.3)	**(11.0)**	11.9
Income from investments in subsidiaries	15	**–**	–	**2.8**	–
Other operating income		**0.7**	0.9	**0.5**	0.6
Total income		**220.9**	221.0	**218.7**	233.1
Administrative expenses	6	**(94.9)**	(92.5)	**(94.5)**	(92.5)
Depreciation and amortisation	16,17	**(4.0)**	(3.0)	**(4.0)**	(3.0)
Impairment gains on loans and advances to customers	8	**1.2**	5.5	**1.2**	5.5
Impairment losses on investments in subsidiary undertakings	15	**–**	–	**(3.8)**	–
Impairment losses on intangible assets	16	**–**	(5.6)	**–**	(5.6)
Impairment losses on property, plant and equipment	17	**–**	(0.9)	**–**	(0.9)
Provisions release / (charge)	22	**0.2**	(3.6)	**0.2**	(3.6)
Loss on sale of financial assets	13	**(6.5)**	–	**(6.5)**	–
Operating profit and profit before tax		**116.9**	120.9	**111.3**	133.0
Tax expense	9	**(27.7)**	(32.9)	**(27.2)**	(32.7)
Profit for the financial year		**89.2**	88.0	**84.1**	100.3

All amounts relate to continuing operations apart from those disclosed in note 13.

The notes on pages 113 to 175 form part of these accounts.

Statements of Comprehensive Income

For the year ended
31 December 2018

	Notes	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Profit for the financial year		**89.2**	88.0	**84.1**	100.3
Items that may subsequently be reclassified to profit and loss:					
Fair value gains / (losses) on available for sale investment securities (*)		**N/A**	(3.4)	**N/A**	(3.4)
(Gains) / losses on available for sale investment securities reclassified to profit or loss on disposal (*)		**N/A**	(0.5)	**N/A**	(0.5)
Fair value gains / (losses) on investment securities measured at fair value through other comprehensive income (*)		**(5.3)**	N/A	**(5.3)**	N/A
(Gains) / losses on investment securities measured through other comprehensive income reclassified to profit or loss on disposal (*)		**(0.8)**	N/A	**(0.8)**	N/A
Tax relating to items that may subsequently be reclassified	26	**1.3**	1.0	**1.3**	1.0
Items that may not subsequently be reclassified to profit and loss:					
Actuarial gain / (loss) on retirement benefit surplus / obligation	24	**8.6**	2.0	**8.6**	2.0
Revaluation loss on properties revalued	17	**(1.0)**	–	**(1.0)**	–
Tax relating to items that may not be reclassified	26	**(4.8)**	(2.4)	**(4.8)**	(2.3)
Total comprehensive income for the year		**87.2**	84.7	**82.1**	97.1

(*) N/A in the above table reflects the change in classification and measurement categories arising on transition from IAS 39 to IFRS 9 on 1 January 2018. The IAS 39 classification of 'available for sale' applied in 2017 no longer applies under IFRS 9; similarly the classification of 'at fair value through other comprehensive income' applied in 2018 did not exist under IAS 39.

Statements of Financial Position

As at 31 December 2018

	Notes	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Assets					
Liquid assets					
Cash in hand and balances with the Bank of England	11	**1,428.0**	1,757.6	**1,428.0**	1,757.6
Loans and advances to credit institutions		**169.7**	194.0	**71.3**	80.9
Investment securities (*)	12	**1,229.1**		**1,552.9**	
Available for sale (*)		**N/A**	763.0	**N/A**	1,290.5
Loans and receivables (*)		**N/A**	15.7	**N/A**	15.7
Derivative financial instruments	35	**273.4**	258.5	**182.8**	167.5
Loans and advances to customers	13				
Loans fully secured on residential property		**15,777.1**	14,908.4	**15,777.1**	14,908.4
Other loans		**256.3**	302.1	**256.3**	302.1
Fair value adjustment for hedged risk on loans and advances to customers		**18.0**	12.5	**18.0**	12.5
Other assets, prepayments and accrued income	14	**160.5**	209.7	**231.9**	304.5
Deferred tax asset	25	**6.4**	1.9	**6.4**	1.0
Investments in subsidiary undertakings	15	**–**	–	**46.6**	59.7
Intangible assets	16	**8.5**	5.2	**8.5**	5.2
Property, plant and equipment	17	**53.0**	54.4	**53.0**	30.6
Retirement benefit surplus	24	**10.1**	1.0	**10.1**	1.0
Total assets		**19,390.1**	18,484.0	**19,642.9**	18,937.2
Liabilities					
Shares	18	**13,909.5**	13,071.5	**13,909.5**	13,071.5
Fair value adjustment for hedged risk on shares		**15.7**	(5.8)	**15.7**	(5.8)
Derivative financial instruments	35	**133.2**	161.9	**132.9**	153.7
Amounts owed to credit institutions		**1,399.3**	951.0	**1,399.3**	951.0
Amounts owed to other customers	19	**211.0**	254.9	**584.7**	871.1
Debt securities in issue	20	**2,260.3**	2,855.7	**2,158.8**	2,702.8
Other liabilities and accruals	21	**188.7**	185.6	**165.7**	175.3
Current tax liabilities		**12.4**	15.6	**12.4**	15.6
Deferred tax liabilities	25	**4.3**	3.2	**3.8**	2.1
Provisions for liabilities and charges	22	**5.0**	6.4	**5.0**	6.4
Subscribed capital	23	**224.2**	25.0	**224.2**	25.0
Total liabilities		**18,363.6**	17,525.0	**18,612.0**	17,968.7
Total equity attributable to members		**1,026.5**	959.0	**1,030.9**	968.5
Total liabilities and equity		**19,390.1**	18,484.0	**19,642.9**	18,937.2

(*) N/A in the above table reflects the change in classification and measurement categories arising on transition from IAS 39 to IFRS 9 on 1 January 2018. The IAS 39 classifications of 'available for sale' and 'loans and receivables' applied to investment securities in 2017 no longer exist under IFRS 9.

The accounts on pages 108 to 175 were approved by the Board of Directors on 26 February 2019.
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 2018

Group 2018	**General Reserve £M**	**Fair value Reserve £M**	**Revaluation Reserve £M**	**Other Reserve £M**	**Total Equity attributable to members £M**
At 1 January 2018	**931.3**	**2.3**	**11.1**	**14.3**	**959.0**
Impact of adoption of IFRS9 at 1 January 2018	**(26.4)**	**0.2**	**–**	**–**	**(26.2)**
Tax relating to adoption of IFRS9 at 1 January 2018	**6.5**	**–**	**–**	**–**	**6.5**
At 1 January 2018 (Restated)	**911.4**	**2.5**	**11.1**	**14.3**	**939.3**
Comprehensive income for the year	**93.9**	**(4.8)**	**(1.9)**	**–**	**87.2**
Revaluation gains transferred on disposal of assets	**1.0**	**–**	**(1.0)**	**–**	**–**
At 31 December 2018	**1,006.3**	**(2.3)**	**8.2**	**14.3**	**1,026.5**

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

Society 2018	**General Reserve £M**	**Fair value Reserve £M**	**Revaluation Reserve £M**	**Other Reserve £M**	**Total Equity attributable to members £M**
At 1 January 2018	**941.0**	**2.3**	**11.1**	**14.1**	**968.5**
Impact of adoption of IFRS9 at 1 January 2018	**(26.4)**	**0.2**	**–**	**–**	**(26.2)**
Tax relating to adoption of IFRS9 at 1 January 2018	**6.5**	**–**	**–**	**–**	**6.5**
At 1 January 2018 (Restated)	**921.1**	**2.5**	**11.1**	**14.1**	**948.8**
Comprehensive income for the year	**88.8**	**(4.8)**	**(1.9)**	**–**	**82.1**
Revaluation gains transferred on disposal of assets	**1.0**	**–**	**(1.0)**	**–**	**–**
At 31 December 2018	**1,010.9**	**(2.3)**	**8.2**	**14.1**	**1,030.9**

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

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

Statements of Cash Flows

For the year ended
31 December 2018

	Notes	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Profit before tax		**116.9**	120.9	**111.3**	133.0
Adjusted for changes in:					
Impairment provision		**(15.8)**	(10.7)	**(15.8)**	(10.7)
Provisions for liabilities and charges		**(1.4)**	1.1	**(1.4)**	1.1
Depreciation and amortisation		**4.0**	3.0	**4.0**	3.0
Impairment losses on intangible assets		**–**	5.6	**–**	5.6
Impairment losses on property, plant and equipment		**–**	0.9	**–**	0.9
Loss on sale of financial assets		**6.5**	–	**6.5**	–
Non-cash and other items		**(20.5)**	50.9	**(15.0)**	65.3
Cash generated from operations		**89.7**	171.7	**89.6**	198.2
Changes in operating assets and liabilities:					
Derivative financial instruments		**(43.6)**	(48.0)	**(36.1)**	(52.7)
Loans and advances to customers		**(813.6)**	(1,792.2)	**(813.6)**	(1,792.2)
Other operating assets		**40.1**	39.5	**63.5**	27.5
Shares		**838.0**	1,869.4	**838.0**	1,869.4
Amounts owed to credit institutions and other customers		**404.4**	276.3	**284.2**	17.2
Other operating liabilities		**34.1**	24.4	**21.5**	16.2
Taxation paid		**(31.2)**	(30.8)	**(31.2)**	(30.8)
Net cash flows from operating activities		**517.9**	510.3	**415.9**	252.8
Cash flows from investing activities					
Purchase of investment securities		**(1,995.1)**	(627.7)	**(1,995.1)**	(627.7)
Proceeds from sale and redemption of investment securities		**1,539.0**	622.3	**1,620.4**	763.6
Change in loans to subsidiary undertakings		**–**	–	**(9.3)**	(21.4)
Purchase of intangible assets		**(4.5)**	(8.4)	**(4.5)**	(8.4)
Purchase of property, plant and equipment		**(4.6)**	(27.6)	**(6.0)**	(3.8)
Proceeds from sale of property, plant and equipment		**2.2**	–	**2.2**	–
Acquisition of subsidiary undertaking		**–**	–	**–**	(23.8)
Net cash flows from investing activities		**(463.0)**	(41.4)	**(392.3)**	78.5
Cash flows from financing activities	27				
Net proceeds from issue of debt securities		**93.0**	574.5	**93.0**	574.5
Repayments of debt securities in issue		**(701.0)**	(218.0)	**(655.0)**	(72.5)
Net proceeds from issue of subscribed capital		**199.2**	–	**199.2**	–
Net cash flows from financing activities		**(408.8)**	356.5	**(362.8)**	502.0
Net (decrease)/increase in cash and cash equivalents		**(353.9)**	825.4	**(339.2)**	833.3
Cash and cash equivalents at the beginning of the year		**1,951.6**	1,126.2	**1,838.5**	1,005.2
Cash and cash equivalents at the end of the year	28	**1,597.7**	1,951.6	**1,499.3**	1,838.5

Notes to the Accounts

Year ended
31 December 2018

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 2018:

- IFRS 9 – Financial Instruments
- IFRS 15 – Revenue from Contracts with Customers

The adoption of IFRS 9 has had a material impact on the financial statements of the Group, and this is disclosed further in note 38. As permitted by the transitional provisions of IFRS 9, the Group has chosen not to restate comparative figures. The initial impact of the adoption of IFRS 9 has been recognised in opening reserves for 2018. The amended disclosure requirements of IFRS 7 have only been applied for the current year. The comparative disclosures repeat those disclosures made in the prior year.

The majority of the Society's income is out of scope of IFRS 15, since it is within scope of IFRS 9. Only fees and commissions receivable and other operating income are in scope of IFRS 15 and the adoption of this standard has not resulted in any changes to the timing of income recognition or any material changes to the accounting policies or financial statements of the Group. Comparative figures have not been restated as the impact is not material.

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 16 – Leases
- IFRS 17 – Insurance Contracts
- IFRIC 23 – Uncertainty over Income Tax Treatments

IFRS 16 will be adopted with effect from 1 January 2019. The most significant impact on the Group is the recognition in the Statement of Financial Position of a right-of-use asset and a lease liability for short leasehold premises where the Society is the lessee and which were previously classified as operating leases.

The Group has chosen to apply the 'modified retrospective' approach to transition, which applies the cumulative effect of initially applying the Standard at the date of adoption with no restatement of comparative information. Further, for all leases, the Group has chosen to measure the right-of-use asset at an amount equal to the lease liability as permitted by the Standard.

The Group expects to apply the practical expedient to account for leases which end within 12 months of the date of adoption as short-term leases, resulting in no right-of-use asset or lease liability being recognised for these leases.

It is currently expected that the initial impact of adoption of IFRS 16 will be an increase in both assets and liabilities of £12.3m, with no material impact on reserves at 1 January 2019.

IFRIC 23 will also be adopted from 1 January 2019 but is not expected to impact the Group. IFRS 17 is effective from 1 January 2022. The impact has not yet been assessed, but is not expected to be material.

(b) Accounting convention
The Group prepares its accounts under the historical cost convention, except for the valuation of financial assets and liabilities held at fair value through other comprehensive income or fair value through profit or loss including 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 15. Uniform accounting policies are applied throughout the Group. Intercompany transactions are eliminated upon consolidation.

Notes to the Accounts

Year ended
31 December 2018 **Continued**

1. Accounting policies continued

(d) Financial instruments
The adoption of IFRS 9 from 1 January 2018 has resulted in a new accounting policy for the classification and measurement of financial instruments.

(i) Classification and measurement

Accounting policy from 1 January 2018:

Financial assets
In accordance with IFRS 9, the Group has classified its financial assets with reference to both the Group's business model for managing the assets and the contractual cash flow characteristics of the assets. The Group's financial assets have been classified into the following categories:

- At amortised cost
  These are assets for which the business model is to hold the asset and collect the contractual cash flows, and those cash flows are solely payments of principal and interest. This means that cash flows typically occur on pre-determined dates and that interest primarily reflects the time value of money, compensation for credit risk and a profit margin.

  The Group has classified the following assets as 'at amortised cost': cash in hand and balances with the Bank of England, loans and advances to credit institutions and loans and advances to customers, with the exception of a collateral loan which represents a pool of equity release mortgages purchased from a third party for which some but not all risks were transferred to the Group.

  Assets held at amortised cost are initially recorded at fair value (usually transaction price) plus any directly attributable costs. They are subsequently measured using the effective interest rate method less provisions for impairment.

- At fair value through other comprehensive income (FVOCI)
  These are categories of assets for which the business model is to hold the asset and collect the contractual cash flows or to sell the assets. The contractual cash flows must be solely payments of principal and interest. The Group holds investment securities in order to meet current and future liquidity requirements, and these are considered to meet the definition of the hold or sell business model. They are therefore classified as 'at FVOCI', apart from those assets for which the cash flows are not solely payments of principal and interest, as noted below.

  These assets are initially recognised at fair value plus any attributable costs. Subsequent changes in fair value are recognised in equity, except for impairment losses which are recognised in the Income Statement. Upon derecognition, any accumulated movements in fair value previously recognised in equity are reclassified to profit or loss in the Income Statement.

  Premia and discounts arising on the purchase of assets held at FVOCI are spread over the life of the asset using the effective interest rate method.

- At fair value through profit or loss (FVTPL)
  Assets for which the business model is neither to hold nor to hold or sell, or those for which contractual cash flows are not solely payments of principal and interest, are classified as 'at FVTPL'. The Group has classified the collateral loan which represents a pool of equity release mortgages as 'at FVTPL' since the underlying contract with the customer contains a guarantee that any shortfall arising on the sale of the property securing the mortgage will not be pursued.

  Certain investment securities are also classified as 'at FVTPL', either because interest can be foregone or because their credit risk is higher than the average credit risk of the underlying collateral. In addition, IFRS 9 has mandated that derivative financial instruments are classified as 'at FVTPL'.

  These assets are initially recognised at fair value and any subsequent changes in fair value are recognised immediately in the Income Statement.

  Purchases and sales of financial assets are recognised at settlement date.

Financial liabilities
All financial liabilities are classified as 'at amortised cost', with the exception of derivative financial instruments which under IFRS 9 are mandatorily classified as 'at FVTPL' and certain shares on which the return is linked to the performance of specific stock market indices, which are also classified as 'at FVTPL'.

Financial liabilities are initially recorded at their fair value, and those to be measured at amortised cost are subsequently measured using the effective interest rate method. 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.

1. Accounting policies continued

(d) Financial instruments (continued)

(i) Classification and measurement (continued)

Accounting policy prior to 1 January 2018:
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:

- *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 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.

1. Accounting policies continued

(d) Financial instruments (continued)

(iv) Derivative financial instruments and hedge accounting
The Group continues to apply the IAS 39 hedge accounting standards, as permitted by IFRS 9.

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 has not had any cash flow hedge relationships in place during the current or prior years or at the end of the current year.

(e) Impairment of financial assets
The adoption of IFRS 9 from 1 January 2018 has resulted in a new accounting policy for impairment of financial assets.

Accounting policy from 1 January 2018:
Impairment losses are calculated for all financial assets held at amortised cost or at FVOCI. Loss provisions are also held against undrawn loan commitments, where a loan offer has been issued to a customer and remains unexpired but the loan has not yet completed and so has not yet been recognised in the Statement of Financial Position.

Impairment losses are calculated on an expected credit loss (ECL) basis. Financial assets are classified individually into one of three stages, as follows:

- **Stage 1** – assets are allocated to this stage on initial recognition and remain in this stage if there is no significant increase in credit risk since initial recognition. Impairment losses are recognised to cover 12 month ECL, being the proportion of lifetime ECL arising from default events expected within 12 months of the reporting date.
- **Stage 2** – assets where it is determined that there has been a significant increase in credit risk since initial recognition, but where there is no objective evidence of impairment. Impairment losses are recognised to cover lifetime ECL.
- **Stage 3** – assets where there is objective evidence of impairment, i.e. they are considered to be in default. Impairment losses are recognised to cover lifetime ECL.

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.

(i) Impairment of loans and advances to customers
The primary driver in determining whether an individual loan has had a significant increase in credit risk is a quantitative assessment of the increase in lifetime probability of default (PD). At each reporting date, lifetime PD is recalculated and compared to the lifetime PD calculated on initial recognition. The loan is allocated to Stage 2 if the lifetime PD has increased over a pre-determined threshold which is set using a test based approach and expressed as a percentage increase, segmented by product type and risk banding at the date of initial recognition.

In addition to the above, a number of qualitative criteria have been set such that loans which are considered to have a significantly increased credit risk but would not be captured above are moved to Stage 2. These qualitative criteria include loans which have reached the end of their contractual term and loans where the customer has been identified as bankrupt but is not in arrears. A backstop is also in place such that all loans which are 30 days past due are moved to Stage 2.

Definition of default: Individual loans are considered to be in default and are allocated to Stage 3 if the loan is more than 90 days past due, is subject to certain forbearance activities, is in possession or if the customer has been identified as bankrupt and is in arrears by more than a nominal amount. A cure period is in place such that the loan would move back to Stage 2 if the loan remains not in default for 12 months or for loans subject to forbearance, if 12 consecutive full payments are made after the forbearance activity has completed.

1. Accounting policies continued

(e) Impairment of financial assets (continued)

(i) Impairment of loans and advances to customers (continued)
ECL is calculated by multiplying loss given default (LGD), probability of default (PD) and exposure at default (EAD). Each element of the calculation is modelled at individual account level on a monthly basis over the remaining life of the loan, with the first 12 months totalled to obtain the 12 month ECL and the lifetime ECL obtained by totalling the above over the full life of the loan. Modelling assumptions are based on historical data analysis of the impact of economic variables on loan behaviour. These assumptions are then applied to the forecast economic scenarios to predict future loan behaviour.

The overall ECL recorded in the financial statements is calculated as the probability weighted ECL over a range of possible forecasted macroeconomic scenarios.

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. The implementation of a forbearance strategy does not give rise to the derecognition of the loan.

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 liquid assets
The Group reviews the external credit ratings of its liquid assets (cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities) at each reporting date. Those assets which are of investment grade (external credit rating of Aaa to Baa3 or equivalent) are considered to have low credit risk and therefore are assumed to have not had a significant increase in credit risk since initial recognition, as allowed by IFRS 9. Liquid assets which are not of investment grade are not expected to be material, but would be assessed on an individual basis.

ECL is calculated by multiplying loss given default (LGD), probability of default (PD) and exposure at default (EAD). LGD is calculated based on publicity available data on historic recovery rates by product and PDs are similarly based on public information and analysis performed by third parties to derive PDs for similar products.

Accounting policy prior to 1 January 2018:
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.

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.

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.

1. Accounting policies continued

(e) Impairment of financial assets (continued)

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
The adoption of IFRS 9 from 1 January 2018 has resulted in a new accounting policy for interest income and expense.

Accounting policy from 1 January 2018:
Interest income and expense on all financial instruments is recognised in interest receivable or payable in the Income Statement. Interest income and expense is calculated using the effective interest rate method for financial assets and liabilities held at amortised cost and at FVOCI.

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. For investment securities, the effective interest rate method spreads any premia or discounts arising on the purchase of the asset over the period to the maturity date of the asset.

Interest received on the collateral loan and investment securities classified as 'at FVTPL' is recognised within 'Interest receivable and similar income'. Amounts accrued and settled in relation to coupon payments and receipts which are contractually due on derivative financial instruments are recognised within 'Interest receivable and similar income' for all derivatives which are economic hedges of financial assets, regardless of whether or not they are in an accounting hedge relationship, and within 'Interest payable and similar charges' for all derivatives which are economic hedges of financial liabilities. All other movements in the fair value of assets held 'at FVTPL' are recognised through 'Fair value gains less losses from financial instruments'.

Accounting policy prior to 1 January 2018:
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 commissions receivable

Accounting policy from 1 January 2018:
Fees and commissions are earned on referral of customers to third party service providers. The Group's performance obligation is satisfied at the point of referral and income is recognised at this point.

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

(g) Fees and commissions receivable (continued)

Accounting policy prior to 1 January 2018:
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.

(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 either on a value in use basis for office property in long term use or open market value.

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

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 obligation 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 obligation, 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.

1. Accounting policies continued

(l) Tax (continued)
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 has 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 71 to 79, 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) Classification of financial assets
Management judgement is applied to the assessment of whether contractual cash flows are solely payments of principal and interest. It has been determined that term extensions and forbearance activity are not contractual so do not impact on the assessment. It was also judged that the potential for certain payments to be foregone, such as due to the existence of the no negative equity guarantee for equity release mortgages underlying the collateral loan, was not consistent with payments being solely principal and interest.

(ii) Impairment losses on loans and advances to customers – significant increase in credit risk
The determination of how significant an increase in lifetime PD should be to trigger a move to Stage 2 for impairment requires significant judgement. The Group has adopted a test based approach to derive objective thresholds such that credit deterioration is recognised at the appropriate point.

If these thresholds moved such that all loans were assessed as having experienced a significant increase in credit risk, such that provisions were recognised to cover lifetime ECL, impairment loss provisions at 31 December 2018 would increase by £5.1m.

(iii) 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 16 for further information).

(b) Significant accounting estimates and assumptions

(i) Impairment losses on loans and advances to customers
Wherever possible, the calculation of impairment loss provisions for loans and advances to customers has been performed using statistical modelling rather than management judgements or estimates. For the UK residential mortgage portfolio, probability of default (PD) is modelled based on analysis of how macroeconomic variables have impacted the performance of loans with similar credit risk characteristics historically.

The significant estimates required for the calculation of impairment loss provisions are forecast macroeconomic variables, in particular UK house price inflation and unemployment, and the probability weightings of the macroeconomic scenarios used. Other macroeconomic variables are modelled, but calculated provisions are not materially sensitive to these.

2. Critical accounting estimates and judgements continued

(b) Significant accounting estimates and assumptions (continued)

(i) Impairment losses on loans and advances to customers (continued)

The Group has used three macroeconomic scenarios, which are considered to represent a range of possible outcomes over a normal economic cycle, in determining impairment loss provisions:

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

Scenarios are developed based on the Group's analysis of third party published economic data and forecasts.

The central scenario represents the Group's current view of the most likely economic outturn. The relative weighting of the macroeconomic scenarios has been estimated by comparing recent movements in economic variables to historic data and trends to ascertain similarities with the periods preceding previous downturns or periods of growth and derive a range of probabilities for such scenarios occurring. At 31 December 2018, additional weighting was given to the downside scenario to reflect uncertainty surrounding the impact of the UK leaving the EU.

The table below shows the key assumptions used in the first three years of the forecast period for each scenario and the assumed weightings:

	31 December 2018			
	Central	**Downside**	**Upside**	**Weighted***
UK house price inflation (2019-2021 cumulative increase / (decrease))	**5.0%**	**(15.0)%**	**8.7%**	**(4.1)%**
UK unemployment (2019-2021 peak rate)	**4.3%**	**7.5%**	**4.1%**	**5.8%**
Probability weighting	**52%**	**46%**	**2%**	

	1 January 2018			
	Central	Downside	Upside	Weighted*
UK house price inflation (2018-2020 cumulative increase / (decrease))	7.9%	(15.1)%	10.8%	0.9%
UK unemployment (2018-2020 peak rate)	5.0%	7.8%	4.6%	5.8%
Probability weighting	54%	32%	14%	

* note that ECLs are calculated for each loan in each scenario and then probability weighted, so the weighted figure shown here is for illustrative purposes only

At 31 December 2018, total impairment loss provisions on residential mortgages were £27.7m. The sensitivity of calculated impairment loss provisions to changes in key individual macroeconomic variables, with all other assumptions held constant is illustrated below.

The impact of changing the assumption for annual house price inflation in each year of the forecast period is shown below. The table also shows the total house price inflation across the first three years of the forecast period implied by applying this sensitivity annually, on a weighted scenario basis.

Movement in annual house price inflation assumption (percentage points)	-5	-2	0	+2	+5
Implied weighted scenario (2019-2021 cumulative increase / (decrease))	(18.0)%	(9.9)%	(4.1)%	1.8%	11.2%
Increase / (decrease) in impairment loss provisions (£M)	25.4	6.0	–	(2.5)	(5.4)

The impact of changing the assumption for the unemployment rate in each year of the forecast period is as follows:

Movement in unemployment rate assumption (percentage points)	-3	-2	-1	0	+1	+2	+3
Implied weighted scenario (2019-2021 peak rate)	2.8%	3.8%	4.8%	5.8%	6.8%	7.8%	8.8%
Increase / (decrease) in impairment loss provisions (£M)	(2.2)	(1.8)	(1.0)	–	5.3	17.0	42.6

In practice the above variables are unlikely to move in isolation. The combined impact of movements in a number of variables can be illustrated by the sensitivity of calculated provisions to scenario weightings. At 31 December 2018:

- if the central scenario was weighted 100%, impairment loss provisions would reduce by £9.8 million; and
- if the downside scenario was weighted 100%, impairment loss provisions would increase by £14.1 million.

For the non-UK residential portfolio, statistical modelling of key variables in the calculation of impairment loss provisions is not possible due to the low volumes of historic loss experience. LGD and PD have been estimated with reference to segments of the UK portfolio with similar characteristics.

Changes to macroeconomic assumptions, as expectations change over time, are expected to lead to volatility in impairment loss provisions, and may lead to pro-cyclicality in the recognition of impairment losses.

2. Critical accounting estimates and judgements continued

(b) Significant accounting estimates and assumptions (continued)

(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 24.

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 (surplus of £10.1m at 31 December 2018). 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 24.

(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 36. For those instruments classed as Level 3, the valuation is in part based on unobservable inputs and therefore requires an element of estimation.

The valuation of the collateral loan which represents a pool of equity release mortgages requires estimates of a number of variables. The variables which are considered to have the largest impact on the value of the loan are the discount rate used to discount future cash flows and long run house price inflation which drives the extent to which losses will arise under the no negative equity guarantee on the underiying mortgages.

At 31 December 2018 the book value of the collateral loan was £229.5m (2017: £247.7m). A 10% proportionate increase in the discount rate used would reduce the value of the collateral loan by £7.1m and a 10% reduction in the discount rate used would increase the value by £7.4m. A 200 basis point reduction in long run house price inflation would reduce the value of the collateral loan by £5.8m and a 200 basis point increase in long run house price inflation would increase the value of the loan by £1.9m. Further sensitivities are shown in note 36(e).

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 dependent on an estimate of the future balance of the portfolio, driven by estimated mortgage prepayment rates. The sensitivity of these valuations to changes in the underlying assumptions is shown in note 36(e).

3. Interest receivable and similar income

	Group 2018 £M	Group 2017 £M	**Society 2018 £M**	Society 2017 £M
Interest receivable calculated using the effective interest rate method:				
On loans fully secured on residential property	**442.2**	435.5	**442.2**	435.5
On other loans and advances to customers	**2.4**	3.2	**2.4**	3.2
On investment securities	**10.2**	8.2	**14.6**	13.0
On other liquid assets	**12.8**	4.9	**12.5**	4.5
Total interest receivable calculated using the effective interest rate method	**467.6**	451.8	**471.7**	456.2
Similar income on instruments held at fair value through profit or loss:				
On other loans and advances to customers	**13.0**	13.2	**13.0**	13.2
On investment securities	**0.2**	0.2	**1.0**	0.6
Net expense on derivatives which hedge financial assets and are designated in accounting hedge relationships	**(18.7)**	(33.4)	**(18.7)**	(33.4)
Net expense on derivatives which hedge financial assets and are not designated in accounting hedge relationships	**(5.1)**	(18.6)	**(16.5)**	(33.9)
Total similar income on instruments held at fair value through profit or loss	**(10.6)**	(38.6)	**(21.2)**	(53.5)
Total interest receivable and similar income	**457.0**	413.2	**450.5**	402.7
Included in the above is:				
Interest receivable on impaired financial assets	**2.1**	3.0	**2.1**	3.0

4. Interest payable and similar charges

	Group 2018 £M	Group 2017 £M	**Society 2018 £M**	Society 2017 £M
Interest payable on instruments not held at fair value through profit or loss				
On shares held by individuals	**175.7**	158.9	**175.7**	158.9
On deposits and other borrowings	**69.1**	67.0	**62.4**	56.9
On subscribed capital	**8.5**	3.3	**8.5**	3.3
Total interest payable on instruments not held at fair value through profit or loss	**253.3**	229.2	**246.6**	219.1
Similar charges on instruments held at fair value through profit or loss				
On shares held by individuals	**0.3**	0.5	**0.3**	0.5
Net income on derivatives which hedge financial liabilities and are designated in accounting hedge relationships	**(7.9)**	(9.6)	**(7.9)**	(9.6)
Net income on derivatives which hedge financial liabilities and are not designated in accounting hedge relationships	**(6.8)**	(20.1)	**(6.7)**	(21.3)
Total similar charges on instruments held at fair value through profit or loss	**(14.4)**	(29.2)	**(14.3)**	(30.4)
Total interest payable and similar charges	**238.9**	200.0	**232.3**	188.7

5. Fair value gains less losses from financial instruments

	Group 2018 £M	Group 2017 £M	**Society 2018 £M**	Society 2017 £M
Change in fair value of financial assets at fair value through profit or loss	**(3.9)**	(14.3)	**(3.9)**	(14.3)
Change in fair value of financial liabilities at fair value through profit or loss	**(5.8)**	15.4	**(6.3)**	14.0
Change in fair value of derivatives in designated fair value hedge accounting relationships	**12.4**	17.0	**18.6**	33.2
Adjustment to hedged items in designated fair value hedge accounting relationships	**(12.6)**	(4.8)	**(18.4)**	(18.8)
Change in fair value of cross currency swap net of retranslation on matched Euro liabilities	**4.2**	(14.6)	**(1.0)**	(2.2)
Total fair value gains less losses from financial instruments	**(5.7)**	(1.3)	**(11.0)**	11.9
The net position on the cross currency swaps includes:				
Fair value gain on cross currency swaps	**43.5**	33.2*	**30.5**	22.2*
Exchange loss on retranslation of matched Euro liabilities	**(39.3)**	(47.8)*	**(31.5)**	(24.4)*

* Prior year restated to provide consistent presentation

The fair value accounting volatility loss arises due to accounting ineffectiveness on designated hedges, or because hedge accounting could not be applied on certain items. For further information refer to notes 35 and 36.

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.

Year ended
31 December 2018 **Continued**

6. Administrative expenses

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Staff costs				
Wages and salaries	**49.0**	47.4	**49.0**	47.4
Social security costs	**4.9**	4.5	**4.9**	4.5
Other pension costs	**6.5**	4.8	**6.5**	4.8
Other staff costs	**1.0**	1.2	**1.0**	1.2
Remuneration of auditor (see below)	**0.6**	0.4	**0.6**	0.4
Other administrative expenses				
Technology	**10.3**	9.9	**10.3**	9.9
Property	**6.6**	6.6	**6.3**	6.6
Marketing	**3.1**	4.0	**3.1**	4.0
Other	**12.9**	13.7	**12.8**	13.7
Total administrative expenses	**94.9**	92.5	**94.5**	92.5

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 £4.9m and variable remuneration of £1.6m (2017: 28 individuals, £4.5m and £1.4m).

The analysis of auditor's remuneration is as follows:

	Group & Society 2018 £000	Group & Society 2017 £000
Fee payable to the Society's auditor for the audit of the Society's annual accounts	**396.2**	247.2
Fees payable to the Society's auditor for the audit of the Society's subsidiaries	**39.5**	42.5
Total audit fees	**435.7**	289.7
Assurance services	**143.6**	156.8
Total non-audit fees	**143.6**	156.8
Fees payable to the Society's auditor and its associates in respect of associated pension schemes	**10.0**	6.6

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

7. Staff numbers

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

	Group & Society	
	2018 Number	2017 Number
Central administration	**1,113**	1,094
Branches	**310**	333
Total average number of persons employed	**1,423**	1,427

At 31 December 2018 the total number of persons employed by the Group and the Society was 1,401 (2017: 1,403). During 2018 the average number of full time equivalent employees of the Group and the Society was 1,308 (2017: 1,322).

Year ended
31 December 2018 **Continued**

8. Impairment on loans and advances to customers

2018 Group & Society	**Loans fully secured on residential property £M**	**Loans fully secured on land £M**	**Other loans £M**	**Total £M**
At 1 January 2018 (*)	**50.2**	**17.2**	**2.5**	**69.9**
Charge / (release) for the year	**3.0**	**(3.6)**	**–**	**(0.6)**
Amount written off during the year	**(4.2)**	**(9.6)**	**–**	**(13.8)**
Release of provision held against loans sold during the year (see note 13)	**(21.3)**	**–**	**–**	**(21.3)**
At 31 December 2018	**27.7**	**4.0**	**2.5**	**34.2**
Income Statement				
Charge / (release) for the year	**3.0**	**(3.6)**	**–**	**(0.6)**
Recoveries of amounts previously written off	**(0.6)**	**–**	**–**	**(0.6)**
Total income statement losses / (gains)	**2.4**	**(3.6)**	**–**	**(1.2)**

(*) The Group adopted IFRS 9 – Financial Instruments with effect from 1 January 2018 and the figures in the above table are presented on this basis. A reconciliation between the closing impairment loss provision under IAS 39 at 31 December 2017 and opening impairment loss provision under IFRS 9 at 1 January 2018 is provided in note 38 (d).

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 2018 **Continued**

9. Tax expense

	Group 2018 £M	Group 2017 £M	**Society 2018 £M**	Society 2017 £M
Analysis of charge in the year				
Current tax				
UK corporation tax on profits for the year	**29.3**	31.7	**29.3**	31.7
Adjustments in respect of previous years	**(0.6)**	1.2	**(0.6)**	1.2
Total current tax	**28.7**	32.9	**28.7**	32.9
Deferred tax				
Origination and reversal of timing differences	**(0.8)**	0.1	**(1.3)**	(0.1)
Adjustments in respect of previous years	**0.2**	(0.1)	**0.2**	(0.1)
Adjustments for changes in tax rates	**(0.4)**	–	**(0.4)**	–
Total deferred tax	**(1.0)**	–	**(1.5)**	(0.2)
Tax on profit on ordinary activities	**27.7**	32.9	**27.2**	32.7
Factors affecting current tax charge for the year:				
Profit on ordinary activities before tax	**116.9**	120.9	**111.3**	133.0
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 19% (2017: 19.25%)	**22.2**	23.3	**21.2**	25.6
Effects of:				
Banking surcharge	**7.1**	7.7	**7.1**	7.7
Adjustment in respect of prior years	**(0.5)**	1.2	**(0.5)**	1.2
Expenses not deductible for tax purposes	**0.8**	0.6	**0.8**	0.6
Income not taxable	**(0.6)**	–	**(0.6)**	(2.4)
Tax rate changes	**0.1**	0.1	**0.1**	–
Other differences	**(1.4)**	–	**(0.9)**	–
	27.7	32.9	**27.2**	32.7

The standard rate of corporation tax applicable to the Group for the year ended 31 December 2018 was 19% (2017: 19.25%). 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.

Notes to the Accounts

Year ended
31 December 2018 **Continued**

10. Classification of financial assets and liabilities

The following table summarises the classification of the carrying value of the Group and Society's financial assets and liabilities:

31 December 2018 Group	**Amortised cost £M**	**FVOCI £M**	**FVTPL £M**	**Total £M**
Financial assets:				
Cash in hand and balances with the Bank of England	**1,428.0**	**–**	**–**	**1,428.0**
Loans and advances to credit institutions	**169.7**	**–**	**–**	**169.7**
Investment securities	**–**	**1,229.1**	**–**	**1,229.1**
Derivative financial instruments	**–**	**–**	**273.4**	**273.4**
Loans and advances to customers:				
Loans fully secured on residential property	**15,777.1**	**–**	**–**	**15,777.1**
Other loans	**26.8**	**–**	**229.5**	**256.3**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**18.0**	**18.0**
Total financial assets	**17,401.6**	**1,229.1**	**520.9**	**19,151.6**
Financial liabilities:				
Shares	**13,909.5**	**–**	**–**	**13,909.5**
Fair value adjustment for hedged risk on shares	**–**	**–**	**15.7**	**15.7**
Derivative financial instruments	**–**	**–**	**133.2**	**133.2**
Amounts owed to credit institutions	**1,399.3**	**–**	**–**	**1,399.3**
Amounts owed to other customers	**211.0**	**–**	**–**	**211.0**
Debt securities in issue	**2,260.3**	**–**	**–**	**2,260.3**
Subscribed capital	**224.2**	**–**	**–**	**224.2**
Total financial liabilities	**18,004.3**	**–**	**148.9**	**18,153.2**

31 December 2017 Group	Amortised cost £M	Available for sale £M	Fair value through Income Statement £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	54.4	–	247.7	302.1
Fair value adjustment for hedged risk on loans and advances to customers	–	–	12.5	12.5
Investment securities	15.7	763.0	–	778.7
Total assets	16,930.1	763.0	518.7	18,211.8
Liabilities and equity:				
Shares	13,041.8	–	29.7	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
Total liabilities and equity	17,128.4	–	185.8	17,314.2

Note that the classifications in the above table reflect the classification of financial instruments under IFRS 9 for 2018 and under IAS 39 for 2017.

Year ended
31 December 2018 **Continued**

10. Classification of financial assets and liabilities continued

31 December 2018 Society	**Amortised cost £M**	**FVOCI £M**	**FVTPL £M**	**Total £M**
Financial assets:				
Cash in hand and balances with the Bank of England	**1,428.0**	**–**	**–**	**1,428.0**
Loans and advances to credit institutions	**71.3**	**–**	**–**	**71.3**
Investment securities	**–**	**1,552.9**	**–**	**1,552.9**
Derivative financial instruments	**–**	**–**	**182.8**	**182.8**
Loans and advances to customers:				
Loans fully secured on residential property	**15,777.1**	**–**	**–**	**15,777.1**
Other loans	**26.8**	**–**	**229.5**	**256.3**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**18.0**	**18.0**
Total financial assets	**17,303.2**	**1,552.9**	**430.3**	**19,286.4**
Financial liabilities:				
Shares	**13,909.5**	**–**	**–**	**13,909.5**
Fair value adjustment for hedged risk on shares	**–**	**–**	**15.7**	**15.7**
Derivative financial instruments	**–**	**–**	**132.9**	**132.9**
Amounts owed to credit institutions	**1,399.3**	**–**	**–**	**1,399.3**
Amounts owed to other customers	**584.7**	**–**	**–**	**584.7**
Debt securities in issue	**2,158.8**	**–**	**–**	**2,158.8**
Subscribed capital	**224.2**	**–**	**–**	**224.2**
Total financial liabilities	**18,276.5**	**–**	**148.6**	**18,425.1**

31 December 2017 Society	Amortised cost £M	Available for sale £M	Fair value through Income Statement £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	80.9	–	–	80.9
Derivative financial instruments	–	–	167.5	167.5
Loans and advances to customers:				
Loans fully secured on residential property	14,908.4	–	–	14,908.4
Other loans	54.4	–	247.7	302.1
Fair value adjustment for hedged risk on loans and advances to customers	–	–	12.5	12.5
Investment securities	15.7	1,290.5	–	1,306.2
Total assets	16,817.0	1,290.5	427.7	18,535.2
Liabilities and equity:				
Shares	13,041.8	–	29.7	13,071.5
Fair value adjustment for hedged risk on shares	–	–	(5.8)	(5.8)
Derivative financial instruments	–	–	153.7	153.7
Amounts owed to credit institutions	951.0	–	–	951.0
Amounts owed to other customers	871.1	–	–	871.1
Debt securities in issue	2,702.8	–	–	2,702.8
Subscribed capital	25.0	–	–	25.0
Total liabilities and equity	17,591.7	–	177.6	17,769.3

Year ended
31 December 2018 **Continued**

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

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Cash in hand	**1.9**	2.1	**1.9**	2.1
Balances with the Bank of England	**1,426.1**	1,755.5	**1,426.1**	1,755.5
Included in cash and cash equivalents (see note 28)	**1,428.0**	1,757.6	**1,428.0**	1,757.6

Balances with the Bank of England do not include mandatory reserve deposits of £40.2m (2017: £23.4m) 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.

12. Investment securities

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Debt securities				
Listed	**1,229.1**	778.7	**1,552.9**	1,167.8
Unlisted (*)	**–**	–	**–**	138.4
Total investment securities	**1,229.1**	778.7	**1,552.9**	1,306.2

(*) The presentation of unlisted Z-notes issued by other Group entities and retained by the Society has been changed in 2018. These are now netted off amounts owed to subsidiary undertakings (see note 19) to more accurately reflect the nature of the transaction.

In addition to those securities held by the Group, the Society has purchased investment securities issued by other Group entities. Investment securities held by the Group and the Society are measured at fair value. The tables below show the changes in fair value during the year. All of the Group's and Society's investment securities at 31 December 2018 are of investment grade. No impairment loss provision is held against these assets since calculated ECL is immaterial (2017: £nil provision under IAS 39). In addition to those securities held by the Group, the Society has purchased investment securities issued by other Group entities.

2018 Group	FVOCI £M	FVTPL £M	Total £M
At 1 January 2018 (**)	**777.2**	**1.7**	**778.9**
Additions	**1,995.0**	**0.1**	**1,995.1**
Disposals (sale and redemption)	**(1,537.2)**	**(1.8)**	**(1,539.0)**
Movement in fair value	**(5.9)**	**–**	**(5.9)**
At 31 December 2018	**1,229.1**	**–**	**1,229.1**

2018 Society	FVOCI £M	FVTPL £M	Total £M
At 1 January 2018	**1,166.3**	**140.1**	**1,306.4**
Additions	**1,995.0**	**0.1**	**1,995.1**
Disposals (sale and redemption)	**(1,602.5)**	**(17.9)**	**(1,620.4)**
Movement in fair value	**(5.9)**	**–**	**(5.9)**
Change in presentation (see above)	**–**	**(122.3)**	**(122.3)**
At 31 December 2018	**1,552.9**	**–**	**1,552.9**

(**) The Group adopted IFRS 9 – Financial instruments with effect from 1 January 2018. The figures in this note are presented under IAS 39 for 2017 and IFRS 9 for 2018. An explanation of the changes to classification and measurement of investment securities on adoption of IFRS 9 can be found in note 38.

12. Investment securities continued

2017 Group	Available for sale £M	Loans and receivables £M	Total £M
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)
Movement in fair value	(5.0)	0.5	(4.5)
At 31 December 2017	763.0	15.7	778.7

2017 Society	Available for sale £M	Loans and receivables £M	Total £M
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)
Movement in fair value	(5.0)	0.5	(4.5)
At 31 December 2017	1,290.5	15.7	1,306.2

Prior to the adoption of IFRS 9 with effect from 1 January 2018, the Society had reclassified 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. 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 compared to a market value of £15.9m. Upon adoption of IFRS 9, these assets were reclassified to FVOCI and their carrying value was adjusted to equal market value.

The fair value gain that would have been recorded directly in reserves in 2017 if the assets had not been reclassified was £0.4m. The net loss, after deferred tax, of £0.9m previously recognised in the available for sale reserve was 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%.

At 31 December 2018, no investment securities were pledged as collateral under sale and repurchase agreements (2017: none).

Year ended
31 December 2018 **Continued**

13. Loans and advances to customers

2018 Group & Society	Gross balance £M	Impairment loss provision (*) £M	Total £M
Loans fully secured on residential property	**15,804.8**	**(27.7)**	**15,777.1**
Loans fully secured on land	**30.8**	**(4.0)**	**26.8**
Other loans	**232.0**	**(2.5)**	**229.5**
Total loans and advances to customers	**16,067.6**	**(34.2)**	**16,033.4**

2017 Group & Society			
Loans fully secured on residential property	14,932.2	(23.8)	14,908.4
Loans fully secured on land	71.6	(17.2)	54.4
Other loans	250.2	(2.5)	247.7
Total loans and advances to customers	15,254.0	(43.5)	15,210.5

(*) The Group adopted IFRS 9 – Financial Instruments with effect from 1 January 2018 and the figures in the above table are presented on this basis. A reconciliation between the closing impairment loss provision under IAS 39 at 31 December 2017 and opening impairment loss provision under IFRS 9 at 1 January 2018 is provided in note 38 (d).

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 in the table above. This loan is measured at fair value through profit or loss. The net fair value movement on loans and advances to customers at fair value through profit or loss was a gain of £0.8m (2017: £4.9m loss) for both the Group and Society.

Loans and advances to customers, for both the Group and Society, include £2,315.3m (2017: £3,080.7m) of loans which have been ringfenced from the Society for its associated secured funding vehicles.

The following transfers have been made:

2018	Covered Bonds LLP £M	Albion No. 3 plc £M	Guildford No.1 plc £M	Total £M
Loans and advances transferred from the Society to securitisation vehicles	**1,815.3**	**126.0**	**374.0**	**2,315.3**
Loan notes issued by securitisation vehicles	**1,108.3**	**136.8**	**400.6**	**1,645.7**

2017	Covered Bonds LLP £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

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.

Year ended
31 December 2018 **Continued**

13. Loans and advances to customers continued

Sale of a portfolio of loans and advances to customers
On 28 June 2018 the Board gave approval to proceed with the sale of a portfolio of loans and advances to customers secured on residential property in the Republic of Ireland. A contract for the sale of the assets was signed on 18 July 2018 and final completion and transfer of legal title occurred on 16 November 2018. The purchaser also acquired cash flows arising from the portfolio since 28 February 2018.

The assets were initially reclassified as held for sale on the date of Board approval and the sale was subsequently recognised on the date the contract was signed.

At completion, the gross value of assets sold (excluding impairment loss provision and fair value adjustments) was £163.6m, including cash flows of £5.2m. The loss on sale, including sale costs, of £6.5m has been recognised in the Income Statement.

The Group and Society's Income Statement for the year includes interest receivable of £0.3m arising from the sold portfolio.

14. Other assets, prepayments and accrued income

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Collateral	**142.4**	194.6	**142.4**	194.6
Prepayments	**4.4**	3.7	**4.4**	3.7
Other assets	**13.7**	11.4	**85.1**	106.2
Total other assets, prepayments and accrued income	**160.5**	209.7	**231.9**	304.5

Other assets include £142.4m (2017: £194.6m) owed by credit institutions on cash collateralisation of derivatives.

15. Investments in subsidiary undertakings

	Society 2018 £M	Society 2017 £M
(a) Shares held in subsidiary undertakings		
Cost		
At 1 January	**3.8**	–
Acquisition of Ravenstone Limited	**–**	3.8
Impairment of investment in Ravenstone Limited	**(3.8)**	–
At 31 December	**–**	3.8
(b) Loans to subsidiary undertakings		
Cost		
At 1 January	**55.9**	14.5
Acquisition of subsidiary	**–**	20.0
Net movement during the year	**(9.3)**	21.4
At 31 December	**46.6**	55.9
Total investments in subsidiary undertakings	**46.6**	59.7

Year ended
31 December 2018 **Continued**

15. Investments in subsidiary undertakings continued

(c) Interest in subsidiary undertakings
The Society holds the following interests in subsidiary undertakings at 31 December 2018, 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 (in liquidation) (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 Member (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 Company 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 (in liquidation)	Provision of residential mortgage backed securities	*	*	35 Great St. Helen's,, London, EC3A 6AP
Albion No. 2 Holdings Limited (in liquidation)	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.

On 18 December 2017 the debt securities issued by Albion No.2 plc were repaid in full and the loans assigned to the company were returned. Consequently the company and its holding company were placed into liquidation during 2018.

The Society received a dividend of £10,850 from Leeds Mortgage Funding Ltd (2017: £nil).

15. Investments in subsidiary undertakings continued

(d) Ravenstone Limited

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 owned 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 was concentrated in a single asset (namely the freehold property) and therefore the acquisition was not treated as a business combination under IFRS 3 – Business Combinations since the acquired company was not classified as a business. The total consideration paid was therefore attributed to the fair value of the freehold property within the financial statements of the Group. No amounts were included in the consolidated Income Statement in respect of Ravenstone Limited for the year ended 31 December 2017.

During 2018, Ravenstone Limited sold the freehold property to the Society for its fair value of £23.8m. Ravenstone used the proceeds to settle its intragroup loan and pay a dividend of £2.8m to the Society. The Society subsequently impaired its £3.8m investment in the shares of Ravenstone Limited and placed the company into liquidation.

16. Intangible assets

2018 Group & Society	**Purchased software £M**	**Development costs £M**	**Total £M**
Cost			
At 1 January 2018	**2.2**	**10.3**	**12.5**
Additions	**–**	**4.5**	**4.5**
Write off of previously impaired assets	**–**	**(5.6)**	**(5.6)**
At 31 December 2018	**2.2**	**9.2**	**11.4**
Amortisation and impairment			
At 1 January 2018	**1.2**	**6.1**	**7.3**
Amortisation charged in the year	**0.4**	**0.8**	**1.2**
Impairment charged in the year	**–**	**–**	**–**
Write off of previously impaired assets	**–**	**(5.6)**	**(5.6)**
At 31 December 2018	**1.6**	**1.3**	**2.9**
Net book value			
At 31 December 2018	**0.6**	**7.9**	**8.5**

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

During 2018 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 2018 impairment of £nil (2017: £5.6m) was recognised in the Income Statement under 'Impairment losses on intangible assets'. The 2017 charge related to one element of development which was fully impaired having ceased prior to completion.

Notes to the Accounts

Year ended
31 December 2018 **Continued**

17. Property, plant and equipment

2018 Group & Society	**Freehold premises £M**	**Long leasehold premises £M**	**Short leasehold premises £M**	**Office and computer equipment £M**	**Total £M**
Cost or valuation					
At 1 January 2018	**44.2**	**0.3**	**1.4**	**31.7**	**77.6**
Additions	**0.3**	**–**	**–**	**4.3**	**4.6**
Disposals	**(2.1)**	**–**	**(0.4)**	**(0.4)**	**(2.9)**
Decrease in value reported in Other Comprehensive Income	**(1.0)**	**–**	**–**	**-**	**(1.0)**
At 31 December 2018	**41.4**	**0.3**	**1.0**	**35.6**	**78.3**
Depreciation and impairment					
At 1 January 2018	**1.1**	**–**	**1.3**	**20.8**	**23.2**
Disposals / reclassifications	**–**	**–**	**(0.3)**	**(0.4)**	**(0.7)**
Depreciation charged in the year	**–**	**–**	**–**	**2.8**	**2.8**
Impairment charged in the year	**–**	**–**	**–**	**–**	**–**
At 31 December 2018	**1.1**	**–**	**1.0**	**23.2**	**25.3**
Net book value					
At 31 December 2018	**40.3**	**0.3**	**–**	**12.4**	**53.0**

2017 Group	Freehold premises £M	Long leasehold premises £M	Short leasehold premises £M	Office and computer equipment £M	Total £M
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 reported in 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

All of the above property, plant and equipment are held by the Society as at 31 December 2018. At 31 December 2017 one freehold property with a valuation of £23.8m was held in Ravenstone Limited. During 2018 this property was sold to the Society. The net book value of the Society's property, plant and equipment is £53.0m (2017: £30.6m). The Society's depreciation charge for the year was £2.8m (2017: £2.4m).

17. Property, plant and equipment continued

The Group's accounting policy is for all freehold and long leasehold premises to be revalued every three years, with the last valuation undertaken as at 31 December 2016 by Knight Frank. In the periods between formal valuations, an assessment is made to ascertain whether there are indications of material changes in property values. At 31 December 2018 one property showed evidence of a decrease in value, resulting in a £1.0m charge to Other Comprehensive Income. Properties will next be revalued at 31 December 2019.
During 2017 impairment of £0.9m was charged against certain office equipment which will not be required in the new head office.

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £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	**31.9**	33.5	**31.9**	9.7
Long leasehold premises	**0.1**	0.1	**0.1**	0.1
Net book value	**32.0**	33.6	**32.0**	9.8
Land and buildings occupied by the Group and Society for its own activities				
Net book value	**12.5**	15.9	**12.5**	15.9

No property, plant and equipment was held under finance leases (2017: none).

18. Shares

	Group & Society	
	2018 £M	2017 £M
Held by individuals	**13,901.5**	13,063.5
Other shares	**8.0**	8.0
Total shares	**13,909.5**	13,071.5

19. Amounts owed to other customers

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Amounts owed to subsidiary undertakings	**–**	–	**373.7**	616.2
Other deposits	**211.0**	254.9	**211.0**	254.9
Total amounts owed to other customers	**211.0**	254.9	**584.7**	871.1

20. Debt securities in issue

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Certificates of deposit	**60.0**	72.0	**60.0**	72.0
Senior unsecured debt	**933.2**	924.2	**933.2**	924.2
Covered bonds	**1,175.4**	1,721.8	**1,165.6**	1,706.6
Residential mortgage backed securities	**91.7**	137.7	**–**	–
Total debt securities in issue	**2,260.3**	2,855.7	**2,158.8**	2,702.8

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 13 for further detail).

Year ended
31 December 2018 **Continued**

21. Other liabilities and accruals

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Accruals	**24.0**	21.7	**23.2**	20.9
Other payables	**164.7**	163.9	**142.5**	154.4
Total other liabilities and accruals	**188.7**	185.6	**165.7**	175.3

Other payables within Group includes £161.4m (2017: £139.3m) owed to credit institutions on cash collateralisation of derivatives, Society £139.4m (2017: £131.7m).

22. Provisions for liabilities and charges

2018	**FSCS Levy £M**	**Customer redress and related provisions £M**	**Commission clawback £M**	**Property related £M**	**Other provisions £M**	**Total £M**
Group & Society						
At 1 January 2018	**1.0**	**4.9**	**0.3**	**0.2**	**–**	**6.4**
Amounts paid during the year	**(0.4)**	**(0.8)**	**–**	**–**	**–**	**(1.2)**
Provision charge / (release) in the year	**(0.3)**	**(0.2)**	**–**	**–**	**0.3**	**(0.2)**
At 31 December 2018	**0.3**	**3.9**	**0.3**	**0.2**	**0.3**	**5.0**

2017	FSCS Levy £M	Customer redress and related provisions £M	Commission clawback £M	Property related £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

Financial Services Compensation Scheme (FSCS) levy
During 2018, the FSCS repaid the remaining balance it owed to HM Treasury relating to the Bradford and Bingley failure in 2008. As a result, 2017/18 was the final year for which a levy was payable in respect of historic banking failures and this was paid during 2018. A £0.3m provision has been made for the levy expected to be paid in January 2019. Refer to note 29 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. During 2018, provisions were released which were no longer considered to be required.

Commission clawback
This provision has been made for the potential clawback of commission on assurance policies sold.

Property related provisions
A provision has been made for potential dilapidations on leased premises following the acquisition of a new head office property by the Group in 2017 which will result in leased property being vacated.

Notes to the Accounts

Year ended
31 December 2018 **Continued**

23. Subscribed capital

	Group & Society	
	2018 £M	2017 £M
13 3/8% permanent interest bearing shares	**25.0**	25.0
3 3/4% tier 2 capital	**199.2**	–

The permanent interest bearing shares (PIBS), which are denominated in sterling, were issued for an indeterminate period and are only repayable in the event of the winding up of the Society. The PIBS have a fixed rate of interest of 13 3/8 % payable semi-annually for an indeterminate period.

In April 2018 the Society issued £200m of tier 2 capital with a maturity date of 2029 to allow it to meet its projected Minimum Requirement for Own Funds and Eligible Liabilities (MREL). This requirement ensures that institutions have a minimum amount of liabilities that can bear losses before and in resolution, allowing the resolution authority to use these financial resources to absorb losses and recapitalise the continuing business.

24. Retirement benefit surplus / (obligation)

(a) Overview of the Society's pension arrangements
The Group operates both defined benefit and defined contribution schemes. In addition, the Group has, for one individual (2017: 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 2018 there were 319 deferred defined benefit members (2017: 337).

The defined benefit scheme operates under UK trust law and the trust is a separate legal entity from the Society. The scheme is governed by a Trustee company, Leeds Building Society Staff Pension Scheme Limited. Directors of the Trustee company are required by law to act in the best interests of scheme members and are responsible for setting certain policies, such as investment and funding, together with the Society.

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. Since the last actuarial valuation was undertaken at 31 December 2017, the Society and the trustees have agreed to implement a lower risk investment strategy. This is expected to comprise a variety of credit assets, such as corporate bonds and gilts, and aims to eliminate risks to the scheme associated with equity investments and the inherent volatility this entails, and move towards a self-sufficient position. Once this new strategy has been agreed, the technical provisions will be reviewed to ensure that the assumptions are appropriate and reflective of the scheme's new investment strategy.

The average duration of the benefit obligation is estimated to be 20 years:

The defined benefit obligation at 31 December 2018 can be approximately attributed to the scheme members as follows:

– Deferred members: 51% (2017: 55%)
– Pensioner members: 49% (2017: 45%)

GMP Equalisation
On 26 October 2018, the High Court issued a ruling that UK pension schemes that have contracted out of the State Earnings Related Pension Scheme will need to equalise benefits for the effect of unequal Guaranteed Minimum Pensions between men and women in relation to service between 17 May 1990 and 5 April 1997. This ruling means that the Society's pension scheme has additional liabilities with effect from 26 October 2018 and these have been treated in these accounts as a past service cost (change in benefit entitlement) which has been charged to the Income Statement. This has resulted in a charge in the Income Statement in 2018 of £1.0m.

(b) Actuarial risks
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

Actuarial gains and losses are recognised immediately in full through the Statements of Comprehensive Income.

24. Retirement benefit surplus / (obligation) continued

(c) Valuation assumptions

The major assumptions used by the Actuary were (in nominal terms):

Group & Society	2018	2017	2016	2015	2014
Rate of increase in salaries*	**–**	–	–	–	4.80%
Rate of increase for pensions in payment**	**3.05%**	3.00%	3.05%	3.00%	2.95%
Rate of increase for deferred pensions**	**3.05%**	3.00%	3.05%	3.15%	3.05%
Discount rate	**2.80%**	2.40%	2.55%	3.80%	3.60%
Inflation assumption RPI	**3.15%**	3.15%	3.20%	3.15%	3.05%
Inflation assumption CPI	**2.15%**	2.15%	2.20%	2.15%	2.05%

* 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 most significant non financial assumption is the assumed rate of longevity, which is based on the SAPS mortality tables known as S2PXA (2017: S2PXA), projected in line with members' years of birth. Future improvements in mortality allowed for are in line with the CMI 2017 projection with a 1.25% per annum 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.

	2018		2017		2016	
Group & Society	Pensioner years	Non-Pensioner years	Pensioner years	Non-Pensioner years	Pensioner years	Non-Pensioner years
Male	**23.7**	**25.2**	23.9	25.4	23.7	25.1
Female	**25.7**	**27.3**	25.8	27.4	25.8	27.3

(d) Reconciliation of funded statement

Group & Society	2018 £M	2017 £M	2016 £M	2015 £M	2014 £M
Present value of pension scheme's liabilities	**(102.5)**	(114.2)	(114.2)	(97.7)	(103.7)
Assets at fair value	**112.6**	115.2	111.6	102.8	105.0
Surplus / (obligation)	**10.1**	1.0	(2.6)	5.1	1.3

The surplus of £10.1m is recognised in the Statement of Financial Position of both the Group and the Society since the Society would be the only beneficiary in the scheme at wind up and therefore it is reasonable to conclude that the residual funds will revert back to the Society without the need for a substantive decision by the trustee.

Changes in the present value of the scheme's liabilities are as follows:

Group & Society	2018 £M	2017 £M
At 1 January	**114.2**	114.2
Interest cost	**2.7**	2.8
Actuarial (gains) / losses	**(10.3)**	2.5
Benefits paid	**(5.1)**	(5.3)
Past service cost	**1.0**	–
At 31 December	**102.5**	114.2

Year ended
31 December 2018 **Continued**

24. Retirement benefit surplus / (obligation) continued

(d) Reconciliation of funded statement (continued)
Changes in the fair value of the scheme's assets are as follows:

Group & Society	2018 £M	2017 £M
At 1 January	115.2	111.6
Interest income	2.7	2.8
Actuarial gains / (losses)	(1.7)	4.5
Contribution by employer	2.0	2.0
Administration expenses	(0.5)	(0.4)
Benefits paid	(5.1)	(5.3)
At 31 December	112.6	115.2

The scheme assets include no assets (2017: no assets) from the Society's own financial instruments and no property (2017: no property) occupied by, or other assets used by, the Society.

(e) Amounts recognised in the Income Statements

Group & Society	2018 £M	2017 £M
Past service cost	1.0	–
Administration expenses	0.5	0.4
Total cost – defined benefit scheme	1.5	0.4

(f) Amounts recognised in the Statements of Comprehensive Income (SOCI)

Group & Society	2018 £M	2017 £M	2016 £M	2015 £M	2014 £M
Experienced (loss) / gain on pension scheme liabilities	10.3	(2.5)	(26.0)	4.2	(13.6)
Percentage of scheme liabilities (%)	10.0%	2.2%	22.8%	4.3%	13.1%
Experienced gain / (loss) on assets	(1.7)	4.5	16.5	(2.1)	6.2
Percentage of scheme assets (%)	1.5%	3.9%	14.8%	2.0%	5.9%
Total gain / (loss) recognised in SOCI during the year	8.6	2.0	(9.5)	2.1	(7.4)

The cumulative amount of actuarial gains and losses recognised in the Statements of Other Comprehensive Income since the date of transition to IFRS is a net loss of £14.1m (2017: £22.6m loss).

(g) 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.

Group & Society	Approximate impact on current surplus £M	Approximate impact on projected pension cost £M
Reduce discount rate by 0.25%	-4.6	+0.1
Increase inflation assumption by 0.25%	-3.1	+0.1
Change long-term trend of increases in mortality improvement from 1.25% per annum to 1.50% per annum	-1.0	+0.0

(h) Estimated contributions for 2019 financial year
Estimated employer normal contributions in financial year 2019 for the Group and the Society are £0.9m, of which £0.5m is in respect of the deficit from the previous actuarial valuation and £0.4m is in respect of scheme expenses and levies.

25. Deferred tax

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Deferred tax				
At 1 January	**(1.3)**	(0.1)	**(1.1)**	(0.2)
Adjustment relating to the adoption of IFRS9 at 1 January 2018	**6.5**	–	**6.5**	–
Adjustment to amounts brought forward	**(0.6)**	0.1	**(0.8)**	0.1
Amount recognised directly in equity	**(3.5)**	(1.2)	**(3.5)**	(1.1)
Income and expenditure movement during the year	**1.0**	(0.1)	**1.5**	0.1
At 31 December	**2.1**	(1.3)	**2.6**	(1.1)

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Deferred tax assets				
IFRS9 transitional adjustment	**6.0**	–	**6.0**	–
Pensions and other post retirement benefits	**–**	1.5	**–**	1.5
Other provisions	**0.4**	0.4	**0.4**	(0.5)
Total deferred tax assets	**6.4**	1.9	**6.4**	1.0

	Group 2018 £M	Group 2017 £M	Society 2018 £M	Society 2017 £M
Deferred tax liabilities				
Gain on revaluation	**2.2**	2.3	**2.2**	2.3
Pensions and other post retirement benefits	**2.5**	–	**2.5**	–
Other temporary differences	**(0.4)**	0.9	**(0.9)**	(0.2)
Total deferred tax liabilities	**4.3**	3.2	**3.8**	2.1

26. Tax effects relating to each component of other comprehensive income

2018	**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
Investment securities at FVOCI	**(6.1)**	**1.3**	**(4.8)**	**(6.1)**	**1.3**	**(4.8)**
Revaluation loss on properties revalued	**(1.0)**	**0.2**	**(0.8)**	**(1.0)**	**0.2**	**(0.8)**
Actuarial gains / (losses) on retirement benefit obligations	**8.6**	**(2.3)**	**6.3**	**8.6**	**(2.3)**	**6.3**
IFRS9 transitional adjustment	**–**	**(0.5)**	**(0.5)**	**–**	**(0.5)**	**(0.5)**
Adjustment to tax in relation to prior periods	**–**	**(2.2)**	**(2.2)**	**–**	**(2.2)**	**(2.2)**
Other comprehensive income	**1.5**	**(3.5)**	**(2.0)**	**1.5**	**(3.5)**	**(2.0)**

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
Adjustments 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)

27. Cash flows from financing activities

For the purposes of the Statements of Cash Flows, debt securities in issue and subscribed capital are classified as liabilities arising from financing activities. The table below provides a reconciliation of movements in liabilities arising from financing activities:

	Group 2018 £M	Group 2017 £M	**Society 2018 £M**	Society 2017 £M
At 1 January	**2,880.7**	2,496.2	**2,727.8**	2,183.0
Cash flows:				
Net proceeds from issue of debt securities	**93.0**	574.5	**93.0**	574.5
Net proceeds from issue of subscribed capital	**199.2**	–	**199.2**	–
Repayments of debt securities in issue	**(701.0)**	(218.0)	**(655.0)**	(72.5)
Non cash flows:				
Amortisation of discount on issue	**0.6**	2.3	**0.6**	2.3
Foreign exchange movements	**21.1**	51.8	**21.1**	51.8
Movement in fair value	**(9.1)**	(26.1)	**(3.7)**	(11.3)
At 31 December	**2,484.5**	2,880.7	**2,383.0**	2,727.8

28. 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 2018 £M	Group 2017 £M	**Society 2018 £M**	Society 2017 £M
Cash in hand and balances with the Bank of England (note 11)	**1,428.0**	1,757.6	**1,428.0**	1,757.6
Loans and advances to credit institutions	**169.7**	194.0	**71.3**	80.9
Total cash and cash equivalents	**1,597.7**	1,951.6	**1,499.3**	1,838.5

The Group's loans and advances to credit institutions includes £76.3m (2017: £105.5m) of balances belonging to the Society's securitisation programmes which are not available for general use by the Society.

29. 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. Although the FSCS has now repaid its borrowings from HM Treasury in relation to historic banking failures, a provision of £0.3m was made during 2018 for further levies payable in 2019 (see note 22).

(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 under executory contracts of £1.5m (2017: £0.8m) relating to technology investment programmes. This amount is inclusive of value added tax.

29. Guarantees and other financial commitments

(d) Lease commitments and service contracts
At 31 December the total undiscounted commitments under non-cancellable operating leases were as set out below:

Group & Society	2018 £M	2017 £M
Land and buildings operating leases		
Commitment expiring:		
Within one year	**1.4**	1.2
Between one and five years inclusive	**5.0**	3.9
After five years	**2.3**	2.4
Total land and buildings operating leases	**8.7**	7.5
Other operating leases and service contracts		
Commitment expiring:		
Within one year	**6.1**	6.1
Between one and five years inclusive	**22.7**	22.7
After five years	**5.5**	11.0
Total other operating leases and service contracts	**34.3**	39.8

30. 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 15. 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.

On 12 July 2018, the Society acquired a freehold office property and sundry other assets from its wholly-owned subsidiary Ravenstone Limited (Ravenstone). Ravenstone had been acquired by the Society in December 2017 in order to obtain control of the property which is intended to become the new head office for the Society.

Total consideration for the purchase was £23.8m, in line with the fair value of the property in the accounts of Ravenstone and the Group. Ravenstone subsequently settled its intragroup loan of £21.0m payable to the Society and declared a dividend of £2.8m. Ravenstone was placed into liquidation in December 2018.

30. Related party transactions continued

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	
	2018 £M	2017 £M	**2018 £M**	2017 £M
Loans payable to the Society				
Loans outstanding at 1 January	**55.9**	14.5	**1.1**	0.6
Net movement during the year	**(9.3)**	41.4	**–**	0.5
Loans outstanding at 31 December	**46.6**	55.9	**1.1**	1.1
Deposits payable by the Society				
Deposits outstanding at 1 January	**616.2**	875.3	**1.3**	1.2
Net movement during the year	**(120.2)**	(259.1)	**(0.6)**	0.1
Change in presentation (see note 12)	**(122.3)**	–	**–**	–
Deposits outstanding at 31 December	**373.7**	616.2	**0.7**	1.3

	2018 £M	2017 £M
Directors' emoluments		
Total remuneration	**3.3**	3.1

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 80 to 94. No directors are active members of the defined benefit section of the Leeds Building Society Pension Scheme (2017: none). Two directors were active members of the defined contribution section of the Leeds Building Society Pension Scheme during 2018 (2017: two).

31. Credit risk on loans and advances to customers

(a) Credit risk management

Credit risk is the risk that borrowers are unable to make their loan payments. 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 with previous years.

The Group's exposure to credit risk on loans and advances to customers can be broken down as below:

	Group & Society	
	2018 £M IFRS 9	2017 £M IAS 39
Retail mortgages	**15,804.8**	14,932.0
Commercial lending	**30.8**	71.6
Other loans	**170.0**	185.3
Total gross exposure (contractual amounts)	**16,005.6**	15,188.9
Impairment loss provisions	**(34.2)**	(43.3)
Fair value adjustments	**62.0**	64.9
Total net exposure	**16,033.4**	15,210.5

31. Credit risk on loans and advances to customers continued

(a) Credit risk management (continued)
Other loans includes a collateral loan secured on equity release mortgages of £167.5m (2017: £182.8m) and an other loan of £2.5m (2017: £2.5m). The collateral loan secured on equity release mortgages is measured at FVTPL and is neither past due nor impaired. The risk relating to this balance arises due to the presence of a guarantee to the equity release mortgage customer whereby any shortfall in the value of the property on redemption of the loan is not pursued. The expected impact of this guarantee is reflected in the calculated fair value of the loan. The overall indexed loan to value on the collateral loan is 34% (2017: 32%) with the value of property on which the equity release mortgages are secured totalling £551m (2017: £577m).

The other loan is not past due but is impaired and is fully provided for.

In addition to the above exposures which are recorded in the Statement of Financial Position, the analysis below also considers undrawn loan commitments where a loan offer has been issued to a customer and remains unexpired but the loan has not yet completed and so has not yet been recognised in the Statement of Financial Position.

(b) Retail credit risk
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.

(i) Credit quality
The following table sets out information about the credit quality of the Group's retail mortgages, which are all fully secured on residential property and are measured at amortised cost, and loan commitments where the amounts in the table represent the amounts committed. Classification into low, medium or high is based on internal rating grades which approximately translate into the IRB probabilities of default (PD) shown in the table. Explanation of the classification of loans into Stages 1 to 3 can be found on page 116.

		2018			
Retail mortgages		**Stage 1 £M**	**Stage 2 £M**	**Stage 3 £M**	**Total £M**
Low	IRB PD < 2.02%	13,605.2	646.2	0.9	14,252.3
Medium	IRB PD ≥ 2.02% and < 25.97%	583.5	648.5	7.7	1,239.7
High	IRB PD ≥ 25.97%	0.3	148.2	164.3	312.8
Total gross exposure		14,189.0	1,442.9	172.9	15,804.8
Impairment loss provision		(3.9)	(9.8)	(14.0)	(27.7)
Net exposure		14,185.1	1,433.1	158.9	15,777.1

		2018			
Loan commitments		**Stage 1 £M**	**Stage 2 £M**	**Stage 3 £M**	**Total £M**
Low	IRB PD < 2.02%	640.6	–	–	640.6
Medium	IRB PD ≥ 2.02% and < 25.97%	35.2	–	–	35.2
High	IRB PD ≥ 25.97%	–	–	–	–
Total gross exposure		675.8	–	–	675.8
Impairment loss provision		–	–	–	–
Net exposure		675.8	–	–	675.8

Year ended
31 December 2018 **Continued**

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(i) Credit quality (continued)

The table below provides further information on the Group's retail mortgages by payment due status as at 31 December 2018, excluding impairment losses. Of the loans and advances secured on residential property in Spain £11.7m (2017: £11.2m) are past due and £0.5m (2017: £0.6m) are in possession. During 2018 the Group disposed of its mortgage portfolio in the Republic of Ireland (see note 13). At 31 December 2017 £37.5m of loans and advances secured on residential property in the Republic of Ireland were past due and £1.2m were in possession.

Group & Society	2018 £M	2018 %	2017 £M	2017 %
– Not past due	15,552.2	98.4	14,613.0	97.8
– Past due up to 3 months	190.8	1.2	221.6	1.4
– Past due 3 to 6 months	28.5	0.2	38.6	0.3
– Past due 6 to 12 months	18.4	0.1	22.5	0.2
– Past due over 12 months	9.5	0.1	28.1	0.2
– Possessions	5.4	–	8.2	0.1
Total gross exposure	15,804.8	100.0	14,932.0	100.0

(ii) Geographical analysis

The geographical distribution of retail mortgages is as follows:

Group & Society	2018 %	2017 %
Scotland	7.9	7.3
North East	3.9	3.9
Yorkshire and Humberside	9.6	9.9
North West	8.4	8.1
Midlands	15.2	14.9
East of England	5.0	4.9
South West	8.7	8.4
Greater London	16.1	16.4
South East	18.9	18.8
Wales	3.1	3.0
Northern Ireland	2.6	2.5
Republic of Ireland	–	1.1
Spain	0.5	0.6
Other	0.1	0.2
Total	100.0	100.0

The Group's retail lending exposures are predominantly in the UK, with some exposure in Spain. During 2018 the Group disposed of its mortgage portfolio in the Republic of Ireland (see note 13). The majority of borrowers in the Spanish portfolio are UK residents and therefore the risk characteristics of this portfolio are considered similar to the rest of the book.

Year ended
31 December 2018 **Continued**

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(iii) Impairment loss provision

The Group's policy for calculating impairment of loans and advances to customers (including retail mortgages and loan commitments) is detailed in note 1. Details of the significant accounting estimates and judgements required in the calculation of impairment loss provisions, including the incorporation of forward looking information, are provided in note 2.

The table below summarises the Group's retail mortgage balances, loan commitments and associated impairment loss provisions, including the position at 1 January 2018 following adoption of IFRS 9:

	31 December 2018			1 January 2018		
	Gross exposure £M	Impairment loss provision £M	Provision coverage %	Gross exposure £M	Impairment loss provision £M	Provision coverage %
Retail mortgages						
Stage 1	14,189.0	3.9	0.03	13,350.5	1.8	0.01
Stage 2 and <30 days past due	1,369.0	8.4	0.62	1,270.5	14.6	1.15
Stage 2 and 30+ days past due	73.9	1.4	1.81	81.9	1.2	1.42
Stage 3	172.9	14.0	8.10	229.1	32.6	14.24
Total retail mortgages	15,804.8	27.7	0.18	14,932.0	50.2	0.34
Loan commitments						
Stage 1	675.8	–	0.01	796.8	–	–

The tables below provide information on movements in the gross retail mortgage exposures and associated impairment loss provisions (calculated under IFRS 9) during the year:

	2018			
Group & Society	Stage 1 12m ECL £M	Stage 2 Lifetime ECL £M	Stage 3 Lifetime ECL £M	Total £M
Gross exposure at 1 January 2018	13,350.5	1,352.4	229.1	14,932.0
Transfers resulting in increased impairment loss provision:				
From Stage 1 to Stage 2	(1,031.9)	1,031.9	–	–
From Stage 1 to Stage 3	(21.0)	–	21.0	–
From Stage 2 to Stage 3	–	(23.6)	23.6	–
Transfers resulting in reduced impairment loss provision:				
From Stage 2 to Stage 1	214.6	(214.6)	–	–
From Stage 3 to Stage 1	10.7	–	(10.7)	–
From Stage 3 to Stage 2	–	36.9	(36.9)	–
New advances	3,758.8	–	–	3,758.8
Redemptions, repayments and disposals	(2,092.7)	(740.1)	(53.2)	(2,886.0)
Gross exposure at 31 December 2018	14,189.0	1,442.9	172.9	15,804.8

Year ended
31 December 2018 **Continued**

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(iii) Impairment loss provision (continued)

Group & Society	2018			
	Stage 1 12m ECL £M	Stage 2 Lifetime ECL £M	Stage 3 Lifetime ECL £M	Total £M
Impairment loss provision at 1 January 2018	1.8	15.8	32.6	50.2
Transfers resulting in increased impairment loss provision:				
From Stage 1 to Stage 2	(0.1)	1.8	–	1.7
From Stage 1 to Stage 3	–	–	0.9	0.9
From Stage 2 to Stage 3	–	(0.3)	3.6	3.3
Transfers resulting in reduced impairment loss provision:				
From Stage 2 to Stage 1	0.2	(1.2)	–	(1.0)
From Stage 3 to Stage 1	–	–	(0.2)	(0.2)
From Stage 3 to Stage 2	–	0.4	(1.1)	(0.7)
Change in impairment loss provision resulting from loan modifications	–	–	(0.7)	(0.7)
Other remeasurement of impairment loss provision (no movement in stage)	1.2	1.5	(0.9)	1.8
New advances	0.9	–	–	0.9
Redemptions, repayments and disposals	(0.1)	(8.2)	(16.0)	(24.3)
Write offs	–	–	(4.2)	(4.2)
Impairment loss provision at 31 December 2018	3.9	9.8	14.0	27.7

(iv) Collateral

Retail mortgages are all fully secured on residential property. The use of such collateral is in line with terms that are usual and customary in standard lending activities.

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 retail mortgage portfolio is as follows:

	Group & Society	
	2018 %	2017 %
<70%	79.1	76.8
70% – 80%	11.7	12.9
80% – 90%	7.0	7.5
>90%	2.2	2.8
Total	100.0	100.0

The overall weighted average loan to value of the retail mortgage portfolio is 55% (2017: 56%). The weighted average loan to value of new lending in 2018 was 61.5% (2017: 63.9%).

31. Credit risk on loans and advances to customers continued

(b) Retail credit risk (continued)

(iv) Collateral (continued)

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	
	2018 £M	2017 £M
Not past due	**15,510.9**	14,565.7
Past due up to 3 months	**187.9**	217.9
Past due over 3 months	**58.8**	89.0
Possessions	**4.5**	7.6
Total collateral	**15,762.1**	14,880.2

(v) Forbearance

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 interests of the borrower.

The table below provides further information on loans existing at the 2018 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 & Society 2018	**Payment arrangement £M**	**Concessions £M**	**Capitalisations £M**	**Transfer to interest only £M**	**Term extensions £M**	**Other £M**	**Total forbearance £M**
Not past due	**11.2**	**1.0**	**5.9**	**29.7**	**100.8**	**1.8**	**150.4**
Past due up to 3 months	**32.4**	**3.5**	**0.4**	**0.4**	**1.3**	**0.7**	**38.7**
Past due over 3 months	**16.7**	**1.0**	**–**	**–**	**–**	**–**	**17.7**
Possessions	**0.4**	**–**	**–**	**0.1**	**–**	**–**	**0.5**
Total forbearance	**60.7**	**5.5**	**6.3**	**30.2**	**102.1**	**2.5**	**207.3**

Group & Society 2017	Payment arrangement £M	Concessions £M	Capitalisations £M	Transfer to interest only £M	Term extensions £M	Other £M	Total forbearance £M
Not past due	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 over 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

(c) Commercial credit risk

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.

Year ended
31 December 2018 **Continued**

31. Credit risk on loans and advances to customers continued

(c) Commercial credit risk (continued)

(i) Credit quality

The following table sets out information about the credit quality of the Group's commercial loans, which are all fully secured on commercial property and are measured at amortised cost. The Group has assessed that all of its commercial loans have experienced a significant increase in credit risk since origination due to changes in the macroeconomic environment impacting the commercial property market since the last loan was originated in 2008.

	2018			
Commercial loans	**Stage 1 £M**	**Stage 2 £M**	**Stage 3 £M**	**Total £M**
Medium	–	23.1	–	23.1
High	–	–	7.7	7.7
Total gross exposure	–	23.1	7.7	30.8
Impairment loss provision	–	(3.3)	(0.7)	(4.0)
Net exposure	–	19.8	7.0	26.8

Loans are classified as medium or high risk based on management judgement and broadly in line with IFRS9 staging criteria.

The table below provides further information on the Group's commercial loans by payment due status as at 31 December 2018, excluding impairment losses.

(ii) Payment due status

Group and Society	**2018 £M**	**2018 %**
- Not past due	30.8	100.0

Group and Society	2017 £M	2017 %
Not impaired:		
- Neither past due nor impaired	32.8	45.7
Impaired:		
- Not past due but impaired	34.8	48.6
- Possessions	4.0	5.7
Total gross exposure	71.6	100.0

One loan that would be past due or impaired has had their terms renegotiated during 2018 (2017: none).

(iii) Industry analysis

The distribution of commercial loans by the borrower's industry sector is as follows:

Group & Society	**2018 %**	2017 %
Leisure and hotel	1.2	4.0
Retail	60.4	29.5
Offices	3.6	34.4
Commercial investment and industrial units	28.2	28.7
Others, including mixed use	6.6	3.4
Total	100.0	100.0

31. Credit risk on loans and advances to customers continued

(c) Commercial credit risk (continued)

(iv) Impairment loss provision

The Group's policy for calculating impairment of loans and advances to customers (including commercial loans) is detailed in note 1. Details of the significant accounting estimates and judgements required in the calculation of impairment loss provisions, including the incorporation of forward looking information, are provided in note 2.

The table below summarises the Group's commercial loans and associated impairment loss provisions, including the position at 1 January 2018 following adoption of IFRS 9:

	31 December 2018			1 January 2018		
	Gross exposure £M	Impairment loss provision £M	Provision coverage %	Gross exposure £M	Impairment loss provision £M	Provision coverage %
Commercial loans						
Stage 1	–	–	–	–	–	–
Stage 2 and <30 days past due	23.1	3.3	14.5	32.2	3.6	11.3
Stage 2 and 30+ days past due	–	–	–	–	–	–
Stage 3	7.7	0.7	9.4	39.4	13.6	34.5
Total commercial loans	30.8	4.0	12.9	71.6	17.2	24.1

The table below reconciles the movement in the commercial loan impairment loss provisions (calculated under IFRS 9) during the year.

Group & Society	2018			
	Stage 1 12m ECL £M	Stage 2 Lifetime ECL £M	Stage 3 Lifetime ECL £M	Total £M
Impairment loss provision at 1 January 2018	–	3.6	13.6	17.2
Transfers from Stage 2 to Stage 3	–	(0.1)	0.1	–
Net remeasurement of impairment provision (no movement in stage)	–	–	(3.4)	(3.4)
Redemptions and disposals	–	(0.2)	–	(0.2)
Write offs	–	–	(9.6)	(9.6)
Impairment loss provision at 31 December 2018	–	3.3	0.7	4.0

(v) Collateral

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 indexed loan to value analysis on the Group's commercial loan portfolio is as follows:

	Group & Society	
	2018 %	2017 %
<70%	28.7	29.5
70% - 80%	31.0	13.3
80% - 90%	5.0	5.4
>90%	35.3	51.8
Total percentage	100.0	100.0

The overall indexed loan to value of the commercial portfolio is 60% (2017: 85%). The fair value of collateral 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 (capped at 100% of the individual loan amount) at 31 December 2018 is shown below, the reduction from the prior year reflecting the reduction in the portfolio size during the year.

31. Credit risk on loans and advances to customers continued

(c) Commercial credit risk (continued)

(v) Commercial LTV (continued)

	Group & Society	
	2018 £M	2017 £M
Not past due (2017 only: not individually impaired)	**30.0**	29.8
Not past due (2017 only: individually impaired)	**N/A**	26.5
Possessions	**–**	3.4
Total collateral	**30.0**	59.7

32. Wholesale credit risk

(a) Summary

The Group holds various investments in order to satisfy operational demand and to meet current and future liquidity 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 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.

Wholesale credit risk also arises on the Group's derivative portfolio, which is used for hedging market risk. This is mitigated through the exchange of collateral through clearing and other netting arrangements.

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.

(b) Credit quality analysis

Counterparty credit ratings are used to inform the Group's assessment of wholesale credit risk. The table below shows the Statement of Financial Position items impacted by wholesale credit risk and provides credit rating details for each exposure. The table shows exposures external to the Group only and does not include debt securities retained by the Society.

2018 (IFRS 9)	**Total £M**	**Aaa**	**Aa1-Aa3**	**A1-A3**	**Baa1-Baa3**	**CCC**	**Unrated**
Group							
Cash in hand and balances with the Bank of England	**1,428.0**	**–**	**1,428.0**	**–**	**–**	**–**	**–**
Loans and advances to credit institutions	**169.7**	**–**	**89.8**	**79.7**	**–**	**–**	**0.2**
Investment securities							
UK Government securities	**457.1**	**–**	**457.1**	**–**	**–**	**–**	**–**
Supranational bonds	**255.6**	**237.5**	**18.1**	**–**	**–**	**–**	**–**
Covered bonds	**328.9**	**328.9**	**–**	**–**	**–**	**–**	**–**
Residential mortgage backed securities	**187.5**	**184.5**	**3.0**	**–**	**–**	**–**	**–**
Permenant interest bearing loans	**–**	**–**	**–**	**–**	**–**	**–**	**–**
Total wholesale exposures	**2,826.8**	**750.9**	**1,996.0**	**79.7**	**–**	**–**	**0.2**
Total	**100.0%**	**26.6%**	**70.6%**	**2.8%**	**–**	**–**	**–**

32. Wholesale credit risk continued

2017 (IAS 39)	Total £M	Aaa	Aa1-Aa3	A1-A3	Baa1-Baa3	CCC	Unrated
Group							
Cash in hand and balances with the Bank of England	1,757.6	–	1,757.6	–	–	–	–
Loans and advances to credit institutions	194.0	–	81.5	106.1	7.3	(1.9)	1.0
Investment securities							
UK Government securities	215.7	–	215.7	–	–	–	–
Supranational bonds	186.5	186.5	–	–	–	–	–
Covered bonds	219.0	219.0	–	–	–	–	–
Residential mortgage backed securities	155.8	148.6	7.2	–	–	–	–
Permenant interest bearing loans	1.7	–	–	–	–	–	1.7
Total wholesale exposures	2,730.3	554.1	2,062.0	106.1	7.3	(1.9)	2.7
Total	100.0%	20.3%	75.5%	3.9%	0.3%	(0.1)%	0.1%

All wholesale exposures are to financial institutions in major industrial countries. The largest exposure to a single institution other than the UK Government was £99.0m (2017: £88.8m).

At 31 December 2018 none of the Group's wholesale portfolio exposure was either past due or impaired (2017: none). There are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

The Group has implemented a policy that initial investments in wholesale assets must be grade A3 or above. At 31 December 2018 100% (2017: 99.7%) of the Group's wholesale investments are rated single A or better.

The Group's accounting policy for the calculation of impairment on wholesale (liquid) assets is detailed in note 1. All wholesale assets were classified as at Stage 1 at 31 December 2018 and throughout the year. No impairment loss provision is held against these assets at 31 December 2018 or throughout the year since calculated ECLs are immaterial.

(c) Concentration risk

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 2018, the Group had exposures to the following geographical regions:

Group	**2018 £M**	**2018 %**	2017 £M	2017 %
UK	**2,548.3**	**90.2**	2,535.7	92.8
Europe split into individual countries as follows:				
Germany	**125.5**	**4.4**	53.9	2.0
Ireland	**1.0**	**–**	0.6	–
Netherlands	**18.1**	**0.6**	–	–
European Supranational	**44.6**	**1.6**	57.3	2.1
North America	**22.0**	**0.8**	7.5	0.3
Global Supranational	**67.3**	**2.4**	54.2	2.0
Far East	**–**	**–**	21.1	0.8
Total wholesale exposures	**2,826.8**	**100.0**	2,730.3	100.0

(d) Collateral

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.

Year ended
31 December 2018 **Continued**

33. Liquidity risk

(a) Summary
Liquidity risk is 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.

(b) Maturity profile of financial assets and liabilities
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 2018 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	1,428.0	–	–	–	–	1,428.0
Loans and advances to credit institutions	–	169.7	–	–	–	169.7
Investment securities	–	26.3	517.8	507.5	177.5	1,229.1
Derivative financial instruments	–	0.5	4.7	231.9	36.3	273.4
Loans and advances to customers						
Loans fully secured on residential property	5.9	5.5	26.6	478.5	15,260.6	15,777.1
Other loans	4.7	7.5	3.7	0.3	240.1	256.3
Fair value adjustment for hedged risk on loans and advances to customers	–	–	3.9	13.5	0.6	18.0
Total financial assets	1,438.6	209.5	556.7	1,231.7	15,715.1	19,151.6
Financial liabilities						
Shares	88.7	5,491.9	3,782.6	4,415.2	131.1	13,909.5
Fair value adjustment for hedged risk on shares	–	0.3	7.3	7.7	0.4	15.7
Derivative financial instruments	–	0.2	5.2	22.9	104.9	133.2
Amounts owed to credit institutions	–	103.9	50.1	1,245.3	–	1,399.3
Amounts owed to other customers	36.8	100.1	73.7	–	0.4	211.0
Debt securities in issue	–	21.1	150.0	1,640.2	449.0	2,260.3
Subscribed capital	–	–	–	–	224.2	224.2
Total financial liabilities	125.5	5,717.5	4,068.9	7,331.3	910.0	18,153.2

33. Liquidity risk continued

(b) Maturity profile of financial assets and liabilities (continued)

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
Investment securities	–	20.9	115.3	490.6	151.9	778.7
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
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	50.1	50.1	–	850.9	–	951.1
Amounts owed to other customers	48.9	140.7	63.1	–	2.1	254.8
Debt securities in issue	–	313.4	313.2	1,790.6	438.5	2,855.7
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

(c) Gross contractual cash flows for financial liabilities

The following tables detail the Group's remaining undiscounted contractual cash flows for its non-derivative 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.

31 December 2018 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**
Shares	**4,856.6**	**1,170.0**	**3,485.3**	**4,517.6**	**96.5**	**14,126.0**
Amounts owed to credit institutions	**–**	**265.2**	**50.2**	**1,237.3**	**–**	**1,552.7**
Amounts owed to other customers	**–**	**153.9**	**78.1**	**–**	**–**	**232.0**
Debt securities in issue	**–**	**21.1**	**54.6**	**1,651.6**	**461.5**	**2,188.8**
Subscribed capital	**–**	**–**	**–**	**–**	**303.8**	**303.8**
Total liabilities	**4,856.6**	**1,610.2**	**3,668.2**	**7,406.5**	**861.8**	**18,403.3**

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
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
Amounts owed to other customers	–	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

Year ended
31 December 2018 **Continued**

33. Liquidity risk continued

(c) Gross contractual cash flows for financial liabilities (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 2018	**Less than 3 months £M**	**3 to 12 months £M**	**1 to 5 years £M**	**Over 5 years £M**	**Total £M**
Swap contracts	**8.3**	**15.7**	**79.5**	**79.6**	**183.1**

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

(d) 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 2018 had £1,168.4m covered bonds in issue (2017: £1,707.3m). In addition, the Group had a further £91.4m (2017: £137.5m) of debt securities in issue through the Albion No. 3 securitisation programme.

The table below illustrates the external secured funding balances after redemptions in the mortgage pool:

	2018		2017	
	Assets pledged £M	**Secured funding £M**	Assets pledged £M	Secured funding £M
Secured against loans and advances to customers – Albion No.3 plc	**126.0**	**91.4**	165.2	137.5
Secured against loans and advances to customers – LBS Covered Bonds LLP	**1,815.3**	**1,168.4**	2,463.1	1,707.3
Total	**1,941.3**	**1,259.8**	2,628.3	1,844.8

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.

34. Market risk

(a) Summary
Market risk is the risk that market movements adversely impact the Group. It is the risk that the value of, or income arising from, the Group's assets and liabilities changes adversely due to movements in market variables, primarily 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 the Board-approved Market Risk Policy. 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.

(b) Interest rate risk
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 2018. 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.

Year ended
31 December 2018 **Continued**

34. Market risk continued

(b) Interest rate risk (continued)

31 December 2018	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	2,130.1	258.2	235.6	198.0	–	–	4.9	2,826.8
Loans and advances to customers	3,718.4	1,024.7	1,680.1	9,297.4	213.4	–	99.4	16,033.4
Total interest bearing assets	5,848.5	1,282.9	1,915.7	9,495.4	213.4	–	104.3	18,860.2
Total non-interest bearing assets	–	–	–	–	–	–	529.9	529.9
Total assets	5,848.5	1,282.9	1,915.7	9,495.4	213.4	–	634.2	19,390.1

	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	5,491.8	1,243.2	2,539.4	4,415.2	131.1	–	88.8	13,909.5
Amounts owed to credit institutions, other customers and debt securities in issue	1,663.9	76.5	36.0	1,598.5	449.5	–	46.2	3,870.6
Subscribed capital	–	–	–	–	199.2	25.0	–	224.2
Total interest bearing liabilities	7,155.7	1,319.7	2,575.4	6,013.7	779.8	25.0	135.0	18,004.3
Total non-interest bearing liabilities and equity	–	–	–	–	–	–	1,385.8	1,385.8
Total liabilities and equity	7,155.7	1,319.7	2,575.4	6,013.7	779.8	25.0	1,520.8	19,390.1
Effect of derivatives	2,274.3	549.5	465.4	(3,540.2)	251.0	–	–	–
Interest rate sensitivity gap	967.1	512.7	(194.3)	(58.5)	(315.4)	28.0	(939.6)	–

34. Market risk continued

(b) Interest rate risk (continued)

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)	–

The Society's interest rate repricing profile is not materially different to the Group position.

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.

34. Market risk continued

(b) Interest rate risk (continued)

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 sensitivity of the Group's and Society's annual earnings 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 & Society	**+200bps 2018 £M**	+200bps 2017 £M	**-200bps 2018 £M**	-200bps 2017 £M
Impact	**52.6**	52.4	**(27.5)**	(18.9)

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 cash flow 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.

(c) Foreign 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:

Group & Society	**Assets 2018 £M**	Assets 2017 £M	**Liabilities 2018 £M**	Liabilities 2017 £M
Euro	**1,863.3**	1,941.7	**1,861.2**	1,945.9

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. At 31 December 2018, a 10% movement in the Sterling: Euro exchange rate would result in a movement of £0.2m in profit or loss or other equity.

(d) 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.

35. Derivative financial instruments and hedge accounting

(a) 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, foreign 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 only.

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	Hedge Accounting
Fixed rate mortgage lending	Sensitivity to changes in interest rates	Pay 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
Fixed rate savings products	Sensitivity to changes in interest rates	Receive 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
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	–
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 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.

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.

35. Derivative financial instruments and hedge accounting continued

(a) Derivative financial instruments (continued)
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.

The table below shows the value of derivatives by type:

	Group 2018			Group 2017		
	Contract or underlying principal amount £M	**Positive fair value £M**	**Negative fair value £M**	Contract or underlying principal amount £M	Positive fair value £M	Negative fair value £M
Interest rate swaps transacted to designate in fair value accounting hedges	**22,572.9**	**63.4**	**(34.2)**	15,048.0	76.9	(45.5)
Derivatives not designated as accounting hedges:						
Equity swaps	**79.4**	**–**	**(72.8)**	109.3	4.7	(64.9)
Interest rate swaps	**685.3**	**14.9**	**(0.2)**	300.5	0.7	(0.8)
Cross currency swaps	**1,933.3**	**193.8**	**(24.6)**	1,968.5	173.0	(47.4)
Floating swaps	**1,339.0**	**1.3**	**(1.4)**	1,589.0	2.3	(1.1)
Bank base rate swaps	**–**	**–**	**–**	905.5	0.9	(2.2)
Total derivatives held for hedging purposes	**26,609.9**	**273.4**	**(133.2)**	19,920.8	258.5	(161.9)

	Society 2018			Society 2017		
	Contract or underlying principal amount £M	**Positive fair value £M**	**Negative fair value £M**	Contract or underlying principal amount £M	Positive fair value £M	Negative fair value £M
Interest rate swaps transacted to designate in fair value accounting hedges	**21,423.8**	**53.2**	**(34.2)**	13,659.6	55.8	(40.9)
Derivatives not designated as accounting hedges:						
Equity swaps	**79.4**	**–**	**(72.7)**	109.3	4.7	(64.9)
Interest rate swaps	**567.4**	**14.9**	**–**	154.7	0.7	–
Cross currency swaps	**919.4**	**113.4**	**(24.6)**	941.6	103.1	(44.6)
Floating swaps	**1,339.0**	**1.3**	**(1.4)**	1,589.0	2.3	(1.1)
Bank base rate swaps	**–**	**–**	**–**	905.5	0.9	(2.2)
Total derivatives held for hedging purposes	**24,329.0**	**182.8**	**(132.9)**	17,359.7	167.5	(153.7)

Year ended
31 December 2018 **Continued**

35. Derivative financial instruments and hedge accounting continued

(a) Derivative financial instruments (continued)
The following tables analyse derivatives by contractual and residual maturity:

	Group 2018		Group 2017	
	Notional principal amount £M	Replacement cost £M	Notional principal amount £M	Replacement cost £M
Under 1 year	5,974.8	5.1	4,688.9	12.6
Between 1 and 5 years inclusive	17,784.3	232.0	12,228.1	213.0
Over 5 years	2,850.8	36.3	3,003.8	32.9
Total derivatives	26,609.9	273.4	19,920.8	258.5

	Society 2018		Society 2017	
	Notional principal amount £M	Replacement cost £M	Notional principal amount £M	Replacement cost £M
Under 1 year	5,974.8	5.1	4,438.9	8.8
Between 1 and 5 years inclusive	16,635.2	172.8	11,089.8	151.7
Over 5 years	1,719.0	4.9	1,831.0	7.0
Total derivatives	24,329.0	182.8	17,359.7	167.5

(b) Hedge accounting
The Group holds a portfolio of fixed rate mortgages, savings and bonds and is therefore exposed to changes in interest rate risk (see note 34). As shown in the table on page 161 the Group manages this risk by entering in to interest rate swaps that either pay or receive a fixed rate.

By entering in to these swaps the Group is hedging interest rate risk only. Other risks, such as credit risk, are managed but not hedged. These risks are managed by entering in to swap contracts with high quality counterparties, requiring the posting of collateral and clearing swaps through central counterparties.

The interest rate risk that arises from fixed rate mortgages and savings is managed by entering in to swaps on a monthly basis. The exposure fluctuates due to new products being added, products maturing and early re-payments in the case of mortgage products. Because of this the Group utilises a dynamic hedging strategy (also known as macro hedging) to manage the exposure created by entering into swap contracts this way.

The Group uses the macro fair value hedges to recognise the changes in fair value of the hedged items (the mortgage and savings products) due to the changes in interest rates and therefore can reduce the impact on profit and loss that would arise if only the changes in fair value from the interest rate swaps was recognised. The main sources of volatility in profit and loss are:

- Differences in interest rates used to discount the fair value of the swap and the hedged item; and
- Differences in the maturity dates of the swaps and hedged items.

In addition to the macro fair value hedges used to manage the interest rate risk of mortgages and savings the Group also uses one-to-one hedges, known as micro hedges, to manage the interest rate risk of fixed rate bond issuances. In this type of hedge a single swap is matched directly against a fixed rate bond and remains matched until maturity or a de-designation event (such as becoming ineffective). The changes in fair value are recognised in the same way as the macro hedge, with the change in the fair value of the bond and swap being offset to reduce volatility in the Income Statement. The main source of ineffectiveness in the micro fair value hedges is differences in the interest rates used to discount the fair value of the swap and hedged item.

Year ended
31 December 2018 **Continued**

35. Derivative financial instruments and hedge accounting continued

(b) Hedge accounting (continued)

The notional value of interest rate swaps designated into hedge relationships is as follows, analysed by maturity date:

31 December 2018	Less than 3 months £M	3 to 12 months £M	1 to 5 years £M	Over 5 years £M
Macro hedge of loans and advances to customers				
Swap notional	257.5	1,682.1	7,192.5	106.7
Average fixed rate	0.8	1.3	1.1	1.3
Macro hedge of shares				
Swap notional	212.0	2,728.5	3,399.6	28.1
Average fixed rate	1.2	1.0	1.1	2.2
Micro hedge of debt securities in issue denominated in Sterling				
Swap notional	–	–	250.0	200.0
Average fixed rate	–	–	4.9	3.8
Micro hedge of debt securities in issue denominated in Euros				
Swap notional	–	–	899.1	449.6
Average fixed rate	–	–	0.8	0.5

The tables below provide analysis of the impacts of hedge accounting on the Statement of Financial Position and the Income Statement:

31 December 2018	Notional amount £M	Carrying Amount Assets £M	Carrying Amount Liabilities £M	Line item in the Statement of Financial Position that includes the hedging instrument	Change in fair value of the hedging instrument used for recognising ineffectiveness in the year £M	Total ineffectiveness recognised in Income Statement £M	Line item in Income Statement that includes hedge effectiveness
Interest rate swaps							
Hedge of loans and advances to customers	9,238.8	29.2	(12.2)	Derivative financial instruments	31.7	(10.0)	Fair value gains less losses from financial instruments
Hedge of shares	6,368.2	6.1	(9.4)	Derivative financial instruments	(10.4)	6.6	Fair value gains less losses from financial instruments
Hedge of debt securities in issue denominated in Sterling	450.0	10.2	–	Derivative financial instruments	(10.9)	(0.3)	Fair value gains less losses from financial instruments
Hedge of debt securities in issue denominated in Euros	1,348.7	9.4	(0.1)	Derivative financial instruments	3.5	3.4	Fair value gains less losses from financial instruments

Year ended
31 December 2018 **Continued**

35. Derivative financial instruments and hedge accounting continued

(b) Hedge accounting (continued)

31 December 2018	Carrying Amount Assets £M	Carrying Amount Liabilities £M	Accumulated amount of fair value adjustments on the hedged item Assets £M	Accumulated amount of fair value adjustments on the hedged item Liabilities £M	Line item in the Statement of Financial Position which includes the hedged item £M	Change in value used to calculate hedge ineffectiveness £M	Accumulated amount of fair value adjustments remaining in the Statement of Financial Position due to items that have ceased to be adjusted for hedging gains or losses £M
Hedged items							
Loans and advances to customers	7,801.1	–	23.7	(8.3)	Fair value adjustment for hedged risk on loans and advances to customers	(21.7)	7.2
Shares	–	6,103.1	6.8	(8.7)	Fair value adjustment for hedged risk on shares	3.8	(15.0)
Debt securities in issue denominated in Sterling	–	452.9	10.0	–	Debt securities in issue	11.2	(1.3)
Debt securities in issue denominated in Euros	–	1,354.3	11.0	(0.1)	Debt securities in issue	(6.9)	11.6

36. Fair values

(a) Carrying value and fair value of financial instruments not carried at fair value

The classification and measurement categories of the Group's financial assets and liabilities under IFRS 9 (for 2018) or IAS 39 (for 2017) are detailed in note 10.

The following tables summarise the carrying amounts and fair values of those financial assets and liabilities not carried at fair value in the Statement of Financial Position. 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.

			Group		Society	
31 December 2018		Fair Value Hierarchy Level	Carrying Value £M	Fair Value £M	Carrying Value £M	Fair Value £M
Financial assets:						
Cash in hand and balances with the Bank of England		Level 1	1,428.0	1,428.0	1,428.0	1,428.0
Loans and advances to credit institutions	i)	Level 2	169.7	169.7	71.3	71.3
Loans and advances to customers						
Loans fully secured on residential property	ii)	Level 3	15,777.1	16,251.2	15,777.1	16,251.2
Other loans	ii)	Level 2	26.8	26.8	26.8	26.8
Financial liabilities:						
Shares	ii)	Level 2	13,909.5	13,922.6	13,909.5	13,922.6
Amounts owed to credit institutions	iv)	Level 2	1,399.3	1,399.3	1,399.3	1,399.3
Amounts owed to other customers	ii)	Level 2	211.0	211.0	584.7	584.7
Debt securities in issue	v)	Level 1	2,123.5	2,318.1	2,158.8	2,328.5
Debt securities in issue	v)	Level 2	136.8	136.9	–	–
Subscribed capital	vi)	Level 1	224.2	272.1	224.2	272.1

Year ended
31 December 2018 **Continued**

36. Fair values continued

(a) Carrying value and fair value of financial instruments not carried at fair value (continued)

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	ii)	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

Figures for the comparative period in the above table reflect the classification of instruments under IAS 39 and have not been restated to reflect changes in classification on adoption of IFRS 9.

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 2018 **Continued**

36. Fair values continued

(b) Fair value measurement basis for financial instruments carried at fair value
The table below classifies all assets and liabilities carried at fair value in the Statement of Financial Position according to the method used to establish their fair value.

31 December 2018 Group	**Level 1 £M**	**Level 2 £M**	**Level 3 £M**	**Total £M**
Assets:				
Investment securities				
At FVOCI	**457.0**	**772.1**	**–**	**1,229.1**
Derivative financial instruments	**–**	**248.5**	**24.9**	**273.4**
Loans and advances to customers	**–**	**–**	**229.5**	**229.5**
Fair value adjustment for hedged risk on loans and advances to customers	**–**	**–**	**18.0**	**18.0**
	457.0	**1,020.6**	**272.4**	**1,750.0**
Liabilities				
Fair value adjustment for hedged risk on shares	**–**	**–**	**15.7**	**15.7**
Derivative financial instruments	**–**	**35.6**	**97.6**	**133.2**
	–	**35.6**	**113.3**	**148.9**

31 December 2017 Group	Level 1 £M	Level 2 £M	Level 3 £M	Total £M
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
	215.7	774.5	291.5	1,281.7
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
	–	100.0	85.8	185.8

Figures for the comparative period in the above table reflect the classification of instruments under IAS 39 and have not been restated to reflect changes in classification on adoption of IFRS 9.

Level 1: Relates to financial instruments where fair values are derived from quoted prices (unadjusted) in active markets 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.

36. Fair values continued

(c) Reconciliation of level 3 fair value measurements of financial instruments

2018	**Financial assets £M**	**Financial liabilities £M**
Balance at 1 January 2018	**291.5**	**(85.8)**
Total (losses) / gains in the Income Statement	**(5.6)**	**(6.0)**
Movement in fair value adjustment for hedged risk on loans and advances to customers	**5.5**	**–**
Movement in fair value adjustment for hedged risk on shares	**–**	**(21.5)**
Net repayment in the year	**(19.0)**	**–**
Balance at 31 December 2018	**272.4**	**(113.3)**

2017	**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 2018 **Continued**

36. Fair values continued

(d) Recurring fair value measurements

Financial assets / Financial liabilities	Fair value as at 31 December 2018	2017	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 – £457.0m	Assets – £215.7m	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 – £772.1m	Assets – £547.3m	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 – £79.4m and Liabilities – £35.6m	Assets – £54.2m and Liabilities – £22.9m	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 – £169.1m	Assets – £173.0m and Liabilities – £47.4m	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	N/A – swaps matured during 2018	Assets – £4.7m	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 – £72.7m	Liabilities – £64.9m	Level 3	Discounted cash flow. 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 and early repayment.	Assumptions on future life expectancy of customers based on best estimate mortality data. Assumptions on the level of early repayment.	An increase in life expectancy or reduction in early repayment will increase the value of the liability.
7. Securitisation swaps	Assets – £24.9m and Liabilities – £24.9m	Assets – £26.6m and Liabilities – £26.7m	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 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 prepayment.	Assumptions on future notional balances related to mortgage prepayment rates.	An increase in prepayment rates will increase the fair value of swaps.

36. Fair values continued

(d) Recurring fair value measurements (continued)

Financial assets/ Financial liabilities	Fair value as at 31 December 2018	2017	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 (collateral loan)	Assets – £229.5m	Assets – £247.7m	Level 3	Discounted cash flow. The valuations are based on a discounted cash flow model which uses projections of interest rates and house price inflation, a discount rate and assumptions for future mortality and early repayment.	Assumptions on future life expectancy of customers based on best estimate mortality data. Assumptions on the level of early repayment, future house prices and the discount rate.	An increase in life expectancy or reduction in early repayment will increase the value of the asset. A reduction in future house prices will reduce the value of the asset, as will an increase in the discount rate.
9. Shares	N/A – products redeemed during 2018	Liabilities – £29.7m	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

(e) Level 3 unobservable inputs

(i) Equity release swaps and loans and advances to customers

The valuation of equity release swaps and the associated collateral loan uses assumptions for future mortality and early repayment. A 5% proportionate increase in early repayment rates would reduce the fair value of the collateral loan by £0.6m. A 5% proportionate reduction in early repayment rates would increase the fair value by £0.6m. Further sensitivities are disclosed in note 2(b).

(ii) Securitisation swaps

These swaps are valued using assumptions for future prepayment. A 5% proportionate increase in prepayments would lead to an increase in the fair value of the swaps of less than £0.1m. A 5% proportionate reduction in prepayments would reduce the fair value by less than £0.1m.

(iii) Fair value adjustment for hedged risk

The Group designates a portfolio of fixed rate mortgages into hedge relationships to mitigate interest rate risk and similarly for a portfolio of fixed rate savings. For the mortgage portfolio only, the calculation of the fair value uses observable market interest rate data and assumptions about projected prepayments. These prepayment assumptions are unobservable inputs that are calculated using historic data and reviewed periodically so that projections are broadly in line with actual data. As such, this is considered a Level 3 valuation technique. A 5% proportionate increase in mortgage repayments would lead to an increase in the fair value of the mortgages in the hedge relationship of less than £0.1m. A 5% proportionate decrease in mortgage repayments would lead to a decrease in the fair value of the mortgages of less than £0.1m.

37. Events after the date of the Statement of Financial Position

There have been no other material subsequent events between 31 December 2018 and the date of approval of these Annual Report and Accounts by the Board.

38. Impact of adoption of IFRS 9 – Financial Instruments

(a) Introduction

IFRS 9 – Financial Instruments was adopted by the Group from 1 January 2018. The standard replaces IAS 39 – Financial Instruments: Recognition and Measurement and has three sections:

- Classification and measurement – the standard introduces new categories for the classification and measurement of financial assets. The classification of assets requires an assessment of the Group's business model for managing the assets and of the contractual cash flow characteristics of the assets. This has resulted in some changes to the classification of assets for the Group but has not had a material impact on carrying values in the Statement of Financial Position at 1 January 2018.

38. Impact of adoption of IFRS 9 – Financial Instruments continued

(a) Introduction (continued)

- Impairment – under IAS 39, impairment loss provisions were calculated on an incurred loss model, whereby provisions were recognised once an impairment 'trigger' event had been identified. IFRS 9 changes this model to an expected credit loss (ECL) model which incorporates forward looking information such that when a financial asset is first recognised, an impairment loss provision is made for the expected losses from defaults over the following 12 months (12 month ECL). If, at a later time, the Group determines that there has been a significant increase in the credit risk of the asset, this impairment loss is increased to cover the expected losses over the whole life of the asset (lifetime ECL). This change in the calculation of impairment losses results in earlier recognition of credit losses in the financial statements but does not change the amount of the eventual loss suffered. This change has resulted in an increase in the Group's provisions for impairment losses.
- Hedge accounting – IFRS 9 alters the rules for the application of hedge accounting, although the rules in relation to portfolio fair value hedges are still under development. Consequently the standard allows entities to continue to apply IAS 39 for all hedge accounting and the Group has chosen to do this.

The adoption of IFRS 9 resulted in a reduction in equity attributable to members at 1 January 2018 of £19.7m. As permitted by the standard, the Group has not restated comparative figures.

(b) Changes to classification and measurement of financial instruments
The changes to measurement category and carrying amounts of financial assets and liabilities on initial adoption of IFRS 9 at 1 January 2018 are as follows:

		Measurement category under IAS 39 £M	Measurement category under IFRS 9 £M	Carrying amount under IAS 39 at 31 December 2017 £M	Carrying amount under IFRS 9 at 1 January 2018 £M
Financial assets					
Cash and balances with the Bank of England		Amortised cost	Amortised cost	1,757.6	1,757.6
Loans and advances to credit institutions		Amortised cost	Amortised cost	194.0	194.0
Derivative financial instruments		FVTPL	FVTPL	258.5	258.5
Loans and advances to customers:					
Loans fully secured on residential property		Amortised cost	Amortised cost	14,908.4	14,882.0
Other loans (*)		Amortised cost	Amortised cost	54.4	54.4
Other loans (**)		FVTPL	FVTPL	247.7	247.7
Fair value adjustment for hedged risk on loans and advances to customers		FVTPL	FVTPL	12.5	12.5
Investment securities	i)	Available for sale	FVOCI	761.3	761.3
Investment securities	ii)	Available for sale	FVTPL	1.7	1.7
Investment securities	iii)	Amortised cost	FVOCI	15.7	15.9
Total financial assets				**18,211.8**	**18,185.6**
Financial liabilities					
Shares		Amortised cost	Amortised cost	13,041.8	13,041.8
Shares		FVTPL	FVTPL	29.7	29.7
Fair value adjustment for hedged risk on shares		FVTPL	FVTPL	(5.8)	(5.8)
Derivative financial instruments		FVTPL	FVTPL	161.9	161.9
Amounts owed to credit institutions		Amortised cost	Amortised cost	951.0	951.0
Amounts owed to other customers		Amortised cost	Amortised cost	254.9	254.9
Debt securities in issue		Amortised cost	Amortised cost	2,855.7	2,855.7
Subscribed capital		Amortised cost	Amortised cost	25.0	25.0
Total financial liabilities				**17,314.2**	**17,314.2**

(*) loans fully secured on land and an other loan (with carrying value of £nil)
(**) collateral loan which represents a pool of equity release mortgages

All classifications of 'at FVTPL' are mandatory under IFRS 9; those loans and advances to customers and shares which were previously measured 'at FVTPL' under IAS 39 were designated as such on initial recognition.

The changes to classification required through application of the requirements of IFRS 9 are as follows:

i) The IAS 39 classification of 'available for sale' no longer exists under IFRS 9. The business model for investment securities is to hold or sell, so those assets where contractual cash flows are solely payments of principal and interest are classified as 'at FVOCI' under IFRS 9. This does not result in a change in measurement basis.

38. Impact of adoption of IFRS 9 – Financial Instruments continued

(b) Changes to classification and measurement of financial instruments (continued)

ii) The Group holds certain investment securities for which the coupon payments can be deferred in certain circumstances. These assets therefore do not meet the requirements of the solely payments of principal and interest test and are classified as 'at FVTPL'.

iii) Under the amendment to IAS 39 issued in October 2008, the Group had reclassified certain investment securities from available for sale to loans and receivables (amortised cost) due to the markets for those assets becoming inactive. Under IFRS 9 this reclassification option is no longer available, and after consideration of the business model and the nature of the contractual cash flows, the assets have been classified as 'at FVOCI'.

(c) Reconciliation of Statement of Financial Position balances from IAS 39 to IFRS 9

The tables below reconcile the carrying amounts of financial assets and liabilities under IAS 39 to those under IFRS 9 on initial adoption of IFRS 9 at 1 January 2018:

		Carrying amount under IAS 39 at 31 December 2017 £M	Reclassification £M	Remeasurement £M	Carrying amount under IFRS 9 at 1 January 2018 £M	Impact on equity attributable to members at 1 January 2018 £M
Financial assets						
Amortised cost						
Cash and balances with the Bank of England		1,757.6			1,757.6	
Loans and advances to credit institutions		194.0			194.0	
Loans and advances to customers – loans fully secured on residential property	i)	14,908.4		(26.4)	14,882.0	(19.9)
Loans and advances to customers – other loans		54.4			54.4	
Investment securities	ii)	15.7	(15.7)		–	–
Total amortised cost		**16,930.1**	**(15.7)**	**(26.4)**	**16,888.0**	**(19.9)**
Available for sale						
Investment securities	iii)	763.0	(763.0)		–	–
Total available for sale		**763.0**	**(763.0)**	**–**	**–**	**–**
FVOCI						
Investment securities	iv)	–	777.0	0.2	777.2	0.2
Total FVOCI		**–**	**777.0**	**0.2**	**777.2**	**0.2**
FVTPL						
Derivative financial instruments		258.5			258.5	
Loans and advances to customers – other loans		247.7			247.7	
Fair value adjustment for hedged risk on loans and advances to customers		12.5			12.5	
Investment securities	v)	–	1.7		1.7	–
Total FVTPL		**518.7**	**1.7**	**–**	**520.4**	**–**
Total financial assets		**18,211.8**	**–**	**(26.2)**	**18,185.6**	**(19.7)**

38. Impact of adoption of IFRS 9 – Financial instruments continued

(c) Reconciliation of Statement of Financial Position balances from IAS 39 to IFRS 9 (continued)

	Carrying amount under IAS 39 at 31 December 2017 £M	Reclassification £M	Remeasurement £M	Carrying amount under IFRS 9 at 1 January 2018 £M	Impact on equity attributable to members at 1 January 2018 £M
Financial liabilities					
Amortised cost					
Shares	13,041.8			13,041.8	
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	
Total amortised cost	**17,128.4**	**–**	**–**	**17,128.4**	**–**
FVTPL					
Shares	29.7			29.7	
Fair value adjustment for hedged risk on shares	(5.8)			(5.8)	
Derivative financial instruments	161.9			161.9	
Total FVTPL	**185.8**	**–**	**–**	**185.8**	**–**
Total financial liabilities	**17,314.2**	**–**	**–**	**17,314.2**	**–**

The changes to carrying values arise due to the following adjustments:

i) Impairment losses remeasured to be calculated on an ECL basis under IFRS 9.

ii) Investment securities previously held at amortised cost reclassified to FVOCI.

iii) £761.3m of investment securities reclassified to FVOCI and £1.7m of investment securities reclassified to FVTPL.

iv) Investment securities reclassified from amortised cost or available for sale, investment securities reclassified from amortised cost also remeasured to be carried at fair value.

v) Investment securities reclassified from available for sale.

Year ended
31 December 2018 **Continued**

38. Impact of adoption of IFRS 9 – Financial Instruments continued

(d) Reconciliation of impairment loss provisions from IAS 39 to IFRS 9

The table below explains the movements in impairment loss provisions from those calculated on an incurred loss model under IAS 39 at 31 December 2017 to those calculated on an expected credit loss model under IFRS 9 on initial adoption of IFRS 9 at 1 January 2018. No movement in impairment arises due to changes in measurement category.

			Loans and advances to customers			
		Liquid assets (*) £M	Loans fully secured on residential property £M	Loans fully secured on land £M	Other loans £M	Total £M
Closing impairment under IAS 39 at 31 December 2017		–	23.8	17.2	2.5	43.5
Less IAS 39 collective impairment not attributed to individual assets	i)	–	(8.0)	(3.6)	–	(11.6)
12 month ECL on assets not individually impaired under IAS 39	ii)	–	1.8	–	–	1.8
Lifetime ECL on assets not individually impaired under IAS 39	iii)	–	25.2	3.6	–	28.8
Additional impairment on assets individually impaired under IAS 39	iv)	–	7.4	–	–	7.4
Impairment loss provision against loan commitments	v)	–	–	–	–	–
Opening impairment under IFRS 9 at 1 January 2018		**–**	**50.2**	**17.2**	**2.5**	**69.9**

(*) total of cash in hand and balances with the Bank of England, loans and advances to credit institutions and investment securities.

The movements in impairment provisions following application of the requirements of IFRS 9 are as follows:

i) Under IAS 39, a collective impairment provision was held where losses were assessed as being present in a portfolio of loans but could not be attributed to individual accounts. The forward looking nature of IFRS 9 ECL calculations means that impairment is calculated for all accounts and no collective provision is made.

ii) For loans allocated to Stage 1 under IFRS 9, a provision is made for 12 month ECL. Under IAS 39 these accounts would not have been individually impaired but would have been in the portfolio for which a collective provision had been made.

iii) For loans allocated to Stage 2 or 3 under IFRS 9, a provision is made for lifetime ECL. This shows the provisions for those accounts which were not individually impaired under IAS 39 but would have been in the portfolio for which a collective provision had been made.

iv) This relates to loans which were previously individually impaired under IAS 39. The different methodology for calculating impairment losses under IFRS 9 (ECL) compared to IAS 39 (incurred loss), such as the use of multiple economic scenarios, results in increased provisions being recorded against these accounts.

v) Under IFRS 9, an impairment provision is required to be held against undrawn loan commitments. Previously, under IAS 37, provisions were only required where the commitment was irrevocable and a loss event had occurred.

38. Impact of adoption of IFRS 9 – Financial Instruments continued

(e) Analysis of financial assets by stage

At 1 January 2018, all cash and balances with the Bank of England, loans and advances to credit institutions and those investment securities classified as 'at FVOCI' were allocated to Stage 1 within the ECL calculations. The resulting ECL was immaterial for these assets, so no impairment loss provisions were made at 1 January 2018.

The table below analyses loans and advances to customers (excluding those measured at FVTPL) and associated ECL by stage on initial adoption of IFRS 9:

		Stage 2			
	Stage 1 £M	<30 dpd (*) £M	30+ dpd (*) £M	Stage 3 £M	Total £M
Gross exposure					
Loans fully secured on residential property	13,350.5	1,270.5	81.9	229.1	14,932.0
Loans fully secured on land	–	32.2	–	39.4	71.6
Other loans	–	–	–	2.5	2.5
Total on Statement of Financial Position	**13,350.5**	**1,302.7**	**81.9**	**271.0**	**15,006.1**
Loan commitments	796.8	–	–	–	796.8
Total gross exposure	**14,147.3**	**1,302.7**	**81.9**	**271.0**	**15,802.9**
ECL					
Loans fully secured on residential property	1.8	14.6	1.2	32.6	50.2
Loans fully secured on land	–	3.6	–	13.6	17.2
Other loans	–	–	–	2.5	2.5
Total on Statement of Financial Position	**1.8**	**18.2**	**1.2**	**48.7**	**69.9**
Loan commitments	0.0	–	–	–	0.0
Total ECL	**1.8**	**18.2**	**1.2**	**48.7**	**69.9**
ECL coverage	**%**	**%**	**%**	**%**	**%**
Loans fully secured on residential property	0.01	1.15	1.42	14.24	0.34
Loans fully secured on land	–	11.30	–	34.49	24.06
Other loans	–	–	–	100.00	100.00
Total on Statement of Financial Position	**0.01**	**1.39**	**1.42**	**17.98**	**0.47**
Loan commitments	0.00	–	–	–	0.00
Total ECL coverage	**0.01**	**1.39**	**1.42**	**17.98**	**0.44**

(*) days past due

Annual Business Statement

Year ended
31 December 2018

1. Statutory percentages

	31 December 2018	Statutory Limit
Lending limit	**4.2%**	25%
Funding limit	**21.8%**	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 and intangible fixed assets.

The funding limit measures the proportion of shares and borrowings (excluding fair value adjustment for hedged risk) not in the form of shares held by individuals.

2. Other percentages

	31 December 2018	31 December 2017
As a percentage of shares and borrowings:		
Gross capital	**7.05%**	5.73%
Free capital	**6.70%**	5.45%
Liquid assets	**15.90%**	15.94%
Profit for the financial year as a percentage of mean total assets	**0.47%**	0.51%
Management expenses as a percentage of mean total assets	**0.52%**	0.56%

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 less tangible and intangible fixed assets;
- '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;
- 'mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year; and
- 'management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Annual Business Statement

Year ended
31 December 2018 **Continued**

3. Information relating to the directors and other officers at 31 December 2018

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 to 31 December 2018)	Senior Independent Director	10.02.54	26.10.10
G J Hoskin (Senior Independent Director and Vice Chairman from 1 January 2019)	Non Executive Director	18.09.60	16.11.15
Chief Executive			
*P A Hill (Chief Executive from 1 August 2006 to 26 February 2019)	Chief Executive Officer	28.07.61	01.08.06
*R G Fearon (Chief Executive from 27 February 2019)	Deputy Chief Executive Officer	16.07.78	19.02.16
Directors			
P A Brown	Non Executive Director	31.03.66	15.01.13
D Fisher	Non Executive Director	02.08.58	27.03.12
*A J Greenwood	Chief Risk Officer	11.12.69	08.01.15
J A Hunt	Non Executive Director	25.09.54	29.04.15
P A Jenks	Non Executive Director	03.01.51	27.03.12
*R S P Litten	Chief Financial Officer	11.05.63	10.01.12
L McManus	Non Executive Director	17.06.68	01.09.17
*K R Wint	Chief Operating Officer	02.05.65	01.12.12

(*executive directors)

The Society's executive director service contracts can be terminated on twelve 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 LS1 2AL.

Details of directors' other directorships

(*Society subsidiary)

R J Ashton	Shawbrook Bank Ltd Shawbrook Group plc
P A Hill	CML Premises Ltd Zeppelin Consulting Ltd
P A Brown	Omnicom Media Group UK Ltd Future Dreams Trust Ltd
R G Fearon	None
D Fisher	P2P Global Investments plc
A J Greenwood	None
G J Hoskin	The British Diabetic Association Diabetes UK Services Ltd
J A Hunt	JCH Associates Ltd
P A Jenks	Broadlands Finance Ltd Charter Court Financial Services Group plc 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 Kane LMMG Ltd
L M Platts	AJ Bell plc Lancashire County Cricket Club
K R Wint	None

Annual Business Statement

Year ended
31 December 2018 **Continued**

Executive management

Name	Occupation	Directorships (*Society subsidiary)
K G Bassett	Chief Internal Auditor	University of Dundee – Audit Committee member
T W Clark	Chief Information Officer	None
K J Green	Director of Products and Distribution	Leeds Federated Housing Association Stanhope Property Ltd
R Hewitt	Director of People	None
N Marsh	Director of Customer and Digital	Trustee of the Point of Care Foundation
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
N Young	Director of Business Transformation	None

Country by Country Reporting

Year ended
31 December 2018

Leeds Building Society provides disclosures below in accordance with the Capital Requirements (Country by Country Reporting) Regulations 2013. The information below has been audited in accordance with the standards required by Directive 2006/43/EC.

Nature and location of the Group's activities

Leeds Building Society is the UK's fifth largest building society with 55 branches (2017: 55), total assets of £19.4bn (2017: £18.5bn) and 804.000 members (2017 restated : 791,000).

The Society's subsidiary undertakings, their country of incorporation and their principal activities are detailed in note 15 on page 133.

The Society has a branch in Gibraltar which deals with mortgage and savings accounts for customers in Gibraltar and for existing customers only in Spain. This branch is controlled from the UK and forms part of the results of Leeds Building Society (i.e. it is not a separate subsidiary). As such it is subject to taxation in the UK. Additionally, it is classified locally as a regulatory branch for which a corporate tax return is submitted and tax is paid (if due) in Gibraltar.

The Society closed its branch in the Republic of Ireland on 30 November 2018 following the sale of its portfolio of Irish mortgages and closure of all Irish savings accounts. This branch was also controlled from the UK and formed part of the results of Leeds Building Society and as such it was subject to taxation in the UK. Additionally, it was classified locally as a regulatory branch and was subject to taxation in the Republic of Ireland.

The Society also has mortgages and savings accounts with UK customers in Spain but has no physical presence or regulatory branch. The results from this activity are included in the results of Leeds Building Society and subject to taxation in the UK.

On 22 December 2017, the Society acquired Ravenstone Limited, a company registered in the Isle of Man, which owned a freehold office property in Leeds City Centre. During the year, Ravenstone Limited sold this property to the Society and Ravenstone Limited was subsequently placed into liquidation.

Results by country

The information for the year ended 31 December 2018 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 and profit before tax are as disclosed in the Group's Income Statement on page 108. Total staff costs are as disclosed in note 6 on page 124. Corporation tax paid represents the total payments as reported in the Statement of Cash Flows on page 112.

2018	UK*	Spain	Republic of Ireland	Total	*UK includes Gibraltar	Isle of Man
Total income (£m)	220.8	0.6	(0.5)	220.9	*0.6*	*(0.6)*
Profit before tax (£m)	125.1	(1.1)	(7.1)	116.9	*0.4*	*(1.0)*
Total assets (£m)	19,313.6	76.5	–	19,390.1	*21.1*	–
Average number of FTEs	1,306	–	2	1,308	*4*	–
Staff costs (£m)	61.2	–	0.2	61.4	*0.1*	–
Corporation tax paid (£m)	31.1	–	0.1	31.2	–	–

Return on assets

The return on assets, calculated as profit before tax divided by mean total assets, was 0.62% (2017: 0.70%) for the year ended 31 December 2018.

Public subsidies received

The Group received no public subsidies in the year ended 31 December 2018.

Glossary of Terms

Year ended
31 December 2018

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 foreign 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 less tangible 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
This applied to the calculation of impairment in 2017 under IAS 39 but does not apply in 2018 under IFRS 9. 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 derivative 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
Assets which are either in the form of cash or are readily convertible into cash. 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.

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 Requirements 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. This is the same as net interest receivable in the Income Statement.

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 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.

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

Debt securities issued by the Group which have certain terms and conditions attached relating to the payment of interest and principal such that they are treated as capital.

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.

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.

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