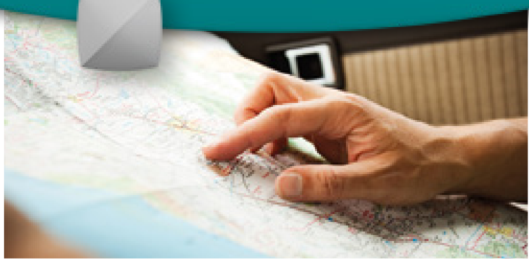




OUR SOCIETY

Yorkshire Building Society
Annual Report & Accounts
2017


YBS GROUP

Delivering long-term value to our membership

A focus on a strong performance throughout 2017.

Group performance at a glance

In a challenging year the Group's performance has been strong.

SAVINGS

RETAIL SAVINGS BALANCES	SAVINGS OUTFLOW	NEW SAVINGS ACCOUNTS OPENED	AVERAGE SAVINGS RATES
£28.9bn	**£0.2bn**	**193,000**	**0.28%**[1]
Balances grew by 0.9%	Compared to an inflow of £0.9bn in 2016	Increased from 114,000 in 2016	Above the rest of market average

MORTGAGES

GROSS LENDING	NET LENDING	OVERALL MORTGAGE BALANCES	SHARE OF GROSS MORTGAGE MARKET
£8.1bn	**£1.0bn**	**£35.1bn**	**3.1%**[2]
Increased by 12.5%	Increased by 46.5%	Balances grew by 2.8%	Compared to 2.9 % in 2016

FINANCIAL

STATUTORY PROFIT BEFORE TAX	CORE OPERATING PROFIT	COMMON EQUITY TIER 1 (CET1) CAPITAL RATIO	LIQUIDITY	COST:INCOME RATIO
£166m	**£160m**	**15.8%**	**15.7%**	**63%**
(2016: £152m)	(2016: £128m)	(2016: 14.9%)	(2016: 12.8%)	(2016: 67%)

+41[3]

Our Net Promoter Score has increased from +34 in 2016.

68%

Colleague engagement score down from 77% in 2016.

87th

Our position in the KPMG Nunwood Customer Experience Excellence Survey[4] decreased from 27th in 2016.

"We are confident that we will be able to build on our solid foundations and manage both challenges and opportunities as they arise."

Any non statutory measures are defined in the Glossary on pages 183 to 187 under the heading Alternative Performance Measures.

Sources:

1 YBS Group average savings rate compared to rest of market average rates based on savings stock from CACI's Current Account and Savings Database (CSDB), covering 86% of the retail savings market (based on stock value). Data period January-October 2017.

2 UK Finance (December 2017).

3 KPMG Nunwood Customer Voice Programme, January– December 2017. Based on 25,107 completed interviews with customers. Net Promoter, Net Promoter Score and NPS are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc., and Fred Reichheld.

4 KPMG Nunwood Consulting – Nunwood Customer Experience Excellence Centre Top 100 UK Brands 2017, 295 participants were subject to the study but only the top 100 is published.

John Heaps
Chairman's welcome

Help for our members when it matters most.

I am pleased to report another year of strong performance in which we have continued to place you, our members and customers, at the heart of everything we do.

We have improved our financial strength whilst at the same time continuing to invest in building our role in society: to provide real help with real life to our over three million customers, with the goal of being 'simply brilliant at mortgages and savings'.

We are proud of our 150 year commitment to our mutual values - delivering long-term value and maintaining a strong, sustainable business which is fit for the future. This means delivering sufficient profit to maintain financial security, returning potential profits above this level to our customers in pricing, service and investment for the future. Everything we do is focused on this strategy, and in 2017, I am pleased to report that we have delivered a profit before tax (PBT) of £166m and improved our capital position across all key measures, whilst at the same time giving value back to our members by maintaining an average savings rate (defined in the glossary on page 185) that is higher than the average for the rest of the market and continuing to invest in our key strategic projects.

Customers at our heart

In 2016 we talked about refocusing the Group's activities on our core business of mortgages and savings. By concentrating on being 'simply brilliant' in those markets we believe that we will be best placed to provide our customers with the products and service they need to make buying their homes and saving for life's key moments as easy and simple as possible.

As a mutual, we have a rich heritage of helping people to buy their own homes and save for what's important to them. In today's world these ambitions can seem harder than ever to achieve as our mortgage customers face average house prices that are almost eight times average earnings – an all-time high. The problem of getting on to and moving up the housing ladder is a reality for many people. The Council of Mortgage Lenders predicted that by 2020 only a quarter of 30-year-olds will own their own home. In contrast, more than half the generation currently approaching retirement were homeowners by their 30th birthday[1].

At the same time a significant proportion of the UK population is finding it increasingly difficult to meet their desire to save. According to the Money Advice Service (MAS)[2], 4 in 10 (16.8m) working-age people across the nation have less than £100 in savings available to them at any time.

1 Council of Mortgage Lenders 'The challenge facing first-time buyers' (April 2015), Department for Communities and Local Government 'Fixing our broken housing market' (February 2017)

2 Money Advice Service 'Low savings levels put millions at financial risk' (September 2016)


TOGETHER

We believe that the need to help people overcome these challenges makes our role in society more relevant than ever. As our members are also our customers, YBS Group is solely focused on providing the products and services our customers need. Understanding those needs is therefore critical to providing real help. A key element of building this understanding in 2017 has been holding focus groups with a variety of members, including both first time buyers, to truly understand the obstacles they have to overcome when trying to buy a first home, and also earlier generations who want to help family members but are having difficulty doing so.

These sessions have led us to develop a number of new products and services which can deliver on our promise to help with real life challenges. We have delivered a number of initiatives in 2017 but there is still much more to do, and I am excited about the further enhancements we have planned for 2018.

These initiatives are outlined in more detail in the Strategic Report that starts on page 12.

For savers, we have held our average savings rates above the average for the rest of the market, and have maintained our savings pledges originally established in 2015 (described in the Strategic Report on pages 20 to 21), which detail what our savings customers can expect from the Group. We know that the current low interest rate and low wage growth environment continues to be challenging for savers, and we will continue to prioritise our support for them as far as possible. It was important that we were able to pass on in full the recent Bank Rate increase to our variable rate savings accounts as demonstration of that commitment.

As we announced early in 2017, we have carried out a number of brand, product and distribution changes. We believe these changes are important to position the Group well for the challenges of the future, as described in the Chief Executive's introduction on page 9. We recognise that this has a significant impact on some of our customers and I would like to take this opportunity to thank them for their continued support. These changes can also be difficult for colleagues and I would like to thank everyone for their commitment and professionalism throughout the year. Our period of change will continue through 2018 and into 2019 as we review the cost base of the Group. We recognise that many colleagues still face an uncertain future and we remain committed to doing all we can to support colleagues at risk of redundancy to find an alternative role in the Group or elsewhere, providing practical help whatever their chosen next step. In 2017 this has included helping a significant number of branch colleagues obtain offers of alternative employment and organising open evenings with local employers. Our people continue to be the foundation of our business and we recognise that they play a vital role in the delivery of the products and services our customers need. That's why we have made significant improvements in developing and recognising the contribution they make, including implementing enhancements to the range of family-friendly practices we offer, and continuing to build a workplace where everyone has the opportunity to reach their potential.

External factors

The UK's impending exit from the European Union (EU) continues to dominate the economic landscape, creating significant uncertainty and volatility in the wider environment. As a result, economic confidence is expected to remain low, resulting in subdued investment as capital spending decisions are delayed until the outlook is brighter, and the future trading relationship with the EU clearer.

In November 2017, inflationary pressures led the Bank of England to increase the Bank Rate from its new historic low of 0.25% to 0.50%, the first increase in over 10 years. However, the combination of slow economic growth and declining real wages does not support rapid Bank Rate increases and this position is not expected to change significantly in the immediate future.

The regulatory environment continues to evolve, with a number of impending changes that will impact the Group, either directly or indirectly. Some of the more significant items are:

- IFRS 9, the new accounting standard, which came into effect at the start of 2018 and will impact loan loss provisioning.
- The changing capital regulations, in particular the Minimum Requirement for Own Funds and Eligible Liabilities (MREL), which will require banks and building societies to hold more loss absorbing capital.
- The Second Payment Services Directive (PSD2) changes and the era of 'open banking', which is already having a significant impact on the way the financial services market operates, opening it up to new business models and encouraging innovation.
- The General Data Protection Regulation (GDPR), which comes into effect in May 2018 and implements a unified approach to data protection across the EU and ultimately aims to give consumers greater control over their personal data. The Group has recently appointed a Data Protection Officer in response to the new data protection laws coming into force.

We also await the results of the Financial Conduct Authority (FCA) Mortgage Market study into competition in the market in the spring of 2018.

Corporate governance

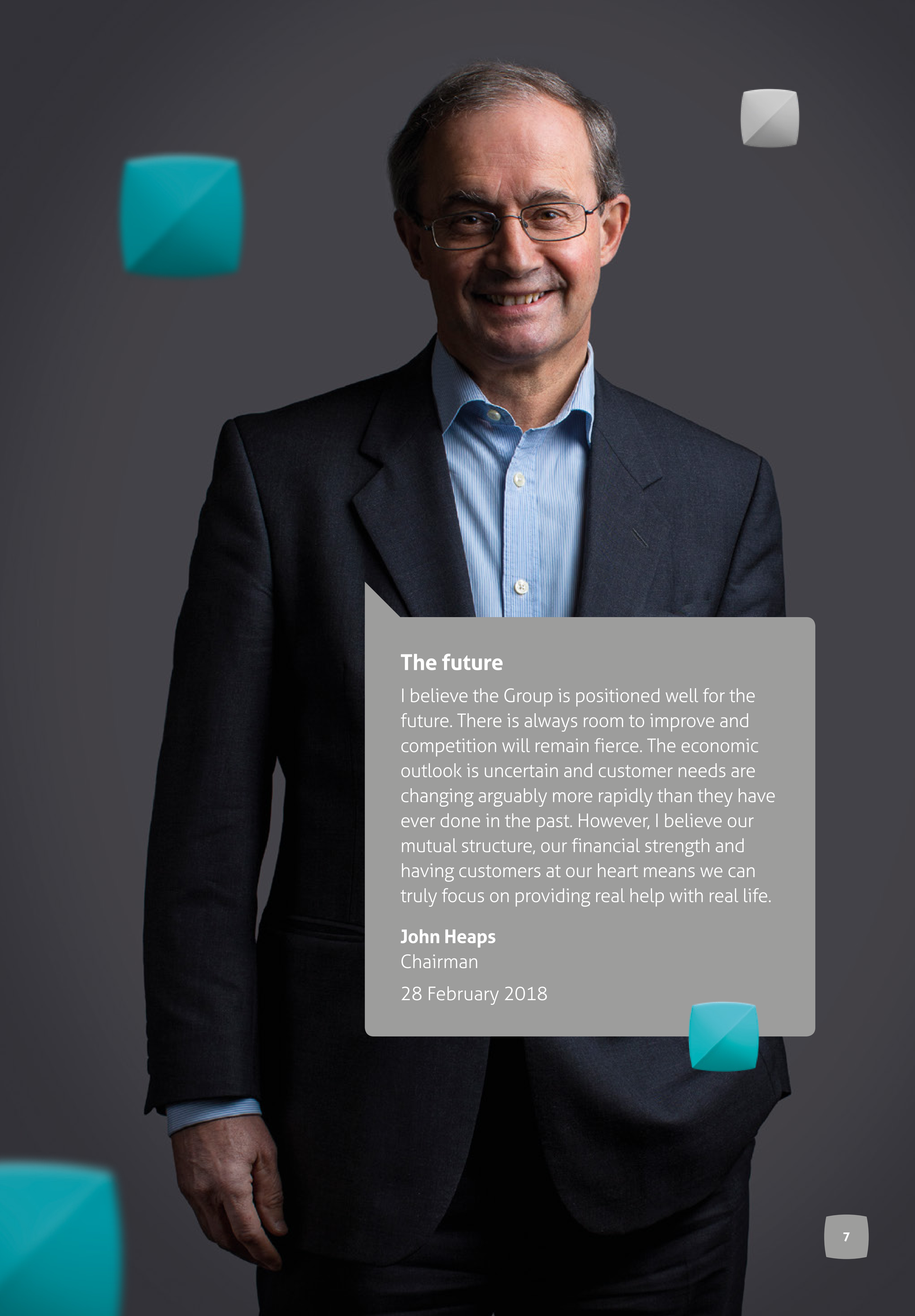
Our approach to corporate governance is based on the principles and provisions of the UK Corporate Governance Code. Following the publication of the Financial Reporting Council's consultation in December 2017, a new Code is expected to be published in summer 2018 and is likely to come into effect for reporting periods from 1 January 2019.

More information on our corporate governance approach and activity is outlined in the report which begins on page 45.

Changes to your Board

I would like to thank those directors that have left the Board (David Paige, Dame Kate Barker and Robin Churchouse) for their outstanding contribution during their time with the Group, a combined length of service of over 30 years. I would also like to extend a warm welcome to our two new Board members in 2017 - Neeta Atkar, who has joined us as a Non Executive Director and Chair of the Group Risk Committee, and Alasdair Lenman, our new Executive Director and Chief Finance Officer.

Further details on changes to Board composition are included in the Corporate Governance Report which begins on page 45.



The future

I believe the Group is positioned well for the future. There is always room to improve and competition will remain fierce. The economic outlook is uncertain and customer needs are changing arguably more rapidly than they have ever done in the past. However, I believe our mutual structure, our financial strength and having customers at our heart means we can truly focus on providing real help with real life.

John Heaps
Chairman

28 February 2018


FOCUS

Mike Regnier
Chief Executive's introduction

I am pleased to introduce the Group's Strategic Report which provides a comprehensive review of the Group's performance in 2017, both financially and against our strategic priority areas.

2017 has been a year of economic and market uncertainty which has seen the UK focused on preparing for its exit from the EU and the possible impact on both wider society and the economy. Although we are not immune to these factors, YBS operates almost exclusively within the UK and so we have maintained focus on our core purpose of helping people with the financial moments that matter. Therefore we provide simple solutions to core financial needs – buying a house of course, but also saving for a family, considering retirement, paying off a mortgage early, and leaving a financial legacy for the next generation. As a mutual organisation, this has been our story for over 150 years and remains our absolute focus today – providing real help with real life.

The current pace of technological change is unprecedented, influencing customer behaviour across all sectors of the economy. The financial services sector is very much part of this. All firms have needed to adapt to evolving customer demands and to learn to compete in a changing environment, with new open banking regulation, more competition and increasingly complex personal financial circumstances, especially for younger people. The Group has successfully come through the financial crisis, the ensuing mergers and regulation changes, but we, along with many others, still have to simplify the business, manage our cost base and move our digital strategy forward. We have decided to focus on our core businesses of savings and mortgages to remain competitive in this rapidly changing environment, and we aim to become 'simply brilliant' in both of these areas. For mortgage customers this means a focus on efficient processes with simple, flexible products and fair pricing, and for savings customers we will continue to provide great long-term value and service, alongside help and support with key life moments.

We announced plans in early 2017 to withdraw our Norwich & Peterborough (N&P) brand from the high street, to close the N&P current account and to close 48 branches across our network. These actions allow us to respond to changes in customer demand and will create efficiency savings to help us remain competitive if margin pressures continue to intensify in the future. The decision to close the sub-scale N&P current account was also a response to new regulation which would have made this even more challenging to operate cost effectively for the wider membership.

We made the branch changes in line with these plans and by the end of the year we had supported 87% of our current account customers to switch or close their account. We have taken a little longer than anticipated to withdraw the current account to make sure we support customers with the transition, recognising the diversity and complexity of individual circumstances. I would particularly like to thank our colleagues in the impacted areas of our business for their professionalism and dedication.

Customers at our heart

Our mutual ownership structure really does allow us to put customers at our heart, and in 2017 we have continued to drive improvements in the speed, efficiency and service across our mortgage processing, building on the progress made in 2016 and increasing both customer and broker satisfaction. This is reflected in our composite Net Promoter Score (NPS)[3], which is defined in the glossary on page 187 and measures how willing our customers and broker partners are to recommend the Group's products and services to others. This increased from +34 in 2016 to +41 in 2017. These efforts have also been recognised through a record year of service awards for the Group, including Most Improved Lender and a 5 Star Rating for Service at the Financial Advisor Service Awards.

Our transformation programme to replace existing mortgage processing systems with market leading technology is now underway, alongside making enhancements to automation and decision engines.

In 2017 we extended our range of products for borrowers who may struggle to access the mortgage market. As I've already noted, in modern Britain things change quickly, and ways of working is one of them, with an ever-growing number of people working for themselves. As an inclusive lender, we have introduced mortgages for people with non-standard incomes, being flexible to give real help to people in a wide range of situations. We have also reintroduced interest only lending through our Accord brand, designed to give customers greater freedom and better control of their financial and personal goals.

In addition we launched a suite of later-life planning products and services through specialist third party providers – helping customers achieve the peace of mind that planning their legacy could provide – with prepaid funeral plans, will writing and legal services.

We are proud to have won a range of awards for our products in 2017, particularly for first time buyers and Offset customers. We also won Best Building Society Mortgage Provider at the 2017 Moneyfacts Awards and Best Intermediary Mortgage Lender at the Your Mortgage Awards.

A record year of service awards for the Group, including Most Improved Lender and a 5 Star Rating for Service at the Financial Advisor Service Awards.

[3] KPMG Nunwood Customer Voice Programme, January-December 2017. Based on 25,107 completed interviews with customers. Net Promoter score and NPS are trademarks of Satmetrix Systems, Inc. Bains & Company, Inc., and Fred Reichheld.

Financial performance

We have responded well to the challenges of 2017, with a strong overall performance, ahead of expectations in some areas.

We have increased our statutory profit before tax to £166m (2016: £152m), which has further strengthened our capital position. In addition, core operating profit (defined in the glossary on page 183) has also increased to £160m (2016: £128m), reflecting the underlying profitability of the Group.

This result reflects a combination of the following:

- Continued investment in supporting our savings customers – we opened 193,000 new savings accounts and maintained our positive savings rate differential compared to the market[4] within or above our target range of 0.15%-0.25% throughout the year.
- Pressure on mortgage margins driven by ongoing market competitiveness, increased remortgage activity and expected reductions in the number of customers on our Standard Variable Rate (SVR) mortgages.
- Focused management of our retail flows to avoid holding significant excess liquidity – this is discussed further in the Strategic Report on page 33.
- Continued use of the low cost government funding available through the Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS) and the wholesale markets.
- Our ongoing investment in transforming our business. This is focused on a combination of cost reduction associated with the brand and distribution changes and other efficiency improvements, further investment in our customer experience and maintaining regulatory compliance.

We have successfully reduced our operating costs by c.£6m through our efficiency programme and focus on value for money, whilst continuing to support our ongoing investment programme. This is reflected in our cost:income ratio, which has reduced to 63% (2016: 67%). Our medium-term goal remains to achieve a ratio of less than 55%. Our management expense ratio (which measures management expenses as a percentage of mean total assets) has also fallen to 0.83% (2016: 0.89%).

Both cost:income ratio and management expense ratio are defined in our glossary on page 183.

Overall, this is a strong performance that delivers profit above the level needed to sustain the business, whilst ensuring we provide strong long-term value to our members through our products and service.

Awards

We are proud to have won the following industry awards in 2017:

Moneynet Personal Finance Awards 2017
- **Best First Time Buyer Mortgage Provider**
- **Best Offset Mortgage Provider**
- **Best Fixed Rate Mortgage Provider (N&P)**

Moneyfacts Consumer Awards 2017
- **First-Time Mortgage Buyers' Choice**

Process Network Excellence Awards 2017
- **Best Business Process Excellence Programme (Under Two Years)**
- **Best Process Improvement Project Under 90 Days**

Annual LSL Group Awards 2017
- **Most Improved Lender (Accord)**

PRmoment Awards 2017
- **Low Budget campaign of the year - in-house**

Chartered Institute of Public Relations Yorkshire & Lincolnshire / PRide Awards
- **Best Use of Media Relations**
- **Low Budget Campaign**

Mortgage Advice Bureau Awards 2017
- **The Relationship Award (Accord)**

Moneywise Mortgage Awards
- **Best lender for discounted rates**
- **Best lender for first-time buyers**

2017 Moneyfacts Awards
- **Best Building Society Mortgage Provider**

What Mortgage Awards
- **Best Offset Mortgage Lender**

Charity Times Awards 2017
- **Corporate National Partnership of the Year with a Financial Institution**

Financial Adviser Service Awards 2017
- **Most Improved Lender (Accord)**

Northern eCommerce Awards
- **Financial service eCommerce website of the year (Accord)**
- **Best online experience (Accord)**

MFG Awards 2018
- **Customer service/Treating customers fairly - large lender (Accord)**
- **Corporate Social Responsibility - lenders**
- **Best BTL lender (Accord)**

Your Mortgage Awards
- **Best Intermediary Mortgage Lender (Accord)**

Collections & Customer Service Awards (CCS Awards)
- **Transformation Programme of the Year**

Trinity Financial Awards
- **Most Improved Lender (Accord)**

Looking ahead

As I noted earlier, change in the financial services market is arguably greater than it has ever been, and we do not expect the pace to diminish in the coming years. There is undoubtedly a drive from consumers towards ever greater digital interaction, which is why our transformation programme includes investment in enhancing our digital capability. However, research shows that there is still strong demand for the face-to-face service that many of our customers value, highlighting that whilst most consumers are happy to carry out simple, day-to-day tasks like checking their balance or paying bills online, nearly two-thirds would prefer to talk to someone face-to-face when making a big financial decision[5].

Against that backdrop we have continued to review our branch and agency network to ensure it meets existing and future customer needs. This review has highlighted both the opportunity to expand into some new towns and cities where we don't currently have a presence, and a need to rebalance and consolidate in locations where we have a high concentration of branches relative to customer demand. As a consequence, our ambition is to expand our retail network into around 50 new locations across the UK, by looking for and working with agencies where there is customer demand. This approach will allow us to reach new locations in a more cost effective way. We have 99 agencies today and we aim to increase this to more than 150 over the next three years.

Last year we also announced our plans to operate a single high street brand to deliver greater efficiencies and long-term value to customers. We will therefore migrate N&P savings customers to Yorkshire Building Society this summer, and retire the N&P brand from the high street. We will also be closing 13 branches during 2018 in locations where we have two or more retail outlets close to each other or where there is both an N&P and YBS presence. As with our recent closures, our absolute focus will be on supporting our customers and colleagues through the transition period.

These actions reflect our focus on delivering value to our members by improving efficiency of service and products. Of course, our colleagues play a vital role in delivering that service and we will continue to invest in creating an inclusive environment in which colleagues have the opportunity to reach their full potential. We have included some highlights of enhancements delivered to date on page 26. At the same time we will remain focused on maintaining a sustainable business, both financially, using our mutual model to provide real benefit to members, and in the wider community, by making sure we create a lasting positive impact on society.

Mike Regnier
Chief Executive

28 February 2018

4 YBS Group average savings rate compared to rest of market average rates based on savings stock from CACI's Current Account and Savings Database (CSDB), covering 86% of the retail savings market (based on stock value). Data period January-October 2017.

5 Social Market Foundation 'Balancing Bricks & Clicks: Understanding how consumers manage their money' (January 2016)

Strategic Report

In this strategic review we set out our assessment of the environment in which we operate, our progress against a range of strategic aims, and the key risks that the Group faces.

Market review

Economic and political overview

Preparations for the UK's exit from the EU have dominated the political debate in 2017 and added to the level of economic uncertainty whilst the terms of the exit and subsequent trading arrangements are negotiated. As the Group operates almost entirely within the UK we anticipate that the direct impact of the exit will be low, with the key threat to the Group being the more general impact on the UK economy – inflation, growth, interest rates and house prices. Uncertainty, coupled with the public spending cuts, has recently led the Office for Budget Responsibility (OBR) to downgrade its UK economic growth forecast, predicting an average of just 1.4% annual growth over the next five years.

Despite record low unemployment, UK wage growth has remained weak, which, coupled with relatively high inflation, has led to a reduction in real wages that is likely to persist for some time yet. Household spending growth has slowed as a consequence and is likely to take some time to recover, and upward pressure has been placed on debt in an already highly indebted economy, a risk to economic stability noted by the Bank of England in its Financial Stability Report in November 2017.

The Group remains alert to these wider macroeconomic risks through its risk management framework and these are reflected in the Group's emerging risks on page 36. Any impact on the Group's key performance indicators (KPIs) could lead to the Group changing its planned activities.

UK mortgage and savings market

Overall housing market activity has been relatively stable in 2017, although the buy-to-let purchase market has remained subdued after the stamp duty change in 2016. In contrast, first time buyer lending has increased, helped by government schemes such as the Help to Buy equity loan. It is too soon to know whether the abolition of Stamp Duty for the majority of first time buyers announced in the Autumn Budget will have the desired effect and boost activity and affordability in this sector. The Building Societies Association (BSA), in their response to the Autumn Budget, noted that Stamp Duty is a more widespread barrier to home movers and not limited to first time buyers, and that lack of housing supply remains the most critical issue[6]. Remortgage activity has increased significantly in the second half of 2017 driven by competition amongst lenders, as well as record low mortgage rates.

In late 2016 the FCA launched a mortgage market study focusing on areas where competition could be improved for the benefit of consumers, particularly seeking to understand whether borrowers have the right information to allow them to choose effectively between products and services, and whether technological solutions could be used to address any problems revealed by the study. The interim report from this review was expected in summer 2017 but has now been delayed to spring 2018. The findings of this review have the potential to impact the mortgage market in the coming years.

The government's Term Funding Scheme (TFS), introduced in 2016 to provide low-cost funding for lenders, has certainly influenced the mortgage market, increasing competition and reducing pricing. Whilst the scheme is now closed for new drawings, the mortgage market remains competitive, characterised by increased remortgage activity and low margins that we believe are likely to persist through 2018.

This combination of low mortgage rates, low unemployment and restricted supply has continued to support house prices, with most indices showing a steady increase in 2017 (Nationwide +2.6%[7], Halifax +2.7%[8]). Many commentators expect the rate of house price growth to slow in 2018, with the Nationwide

[6] Building Societies Association 'The BSA comments on the Autumn Budget 2017' (November 2017)

[7] Nationwide House Price Index annual change (December 2017)

[8] Halifax House Price Index annual change (December 2017)

Building Society forecasting prices to grow by 1% nationally, potentially masking underlying regional variations. Restricted supply is generally expected to re-establish house price growth in the short to medium-term, although many commentators have highlighted the possible impact of economic and political uncertainty on their forecasts.

Savings rates have remained at historically low levels driven by the low mortgage rates and availability of low cost funding through the TFS. Savings levels in the market as a whole have been significantly lower than in 2016 as the income squeeze bites and savers seek higher returns in the low rate environment. There has been some improvement for savers as the Bank of England increased its Bank Rate in November 2017 by 0.25% to 0.5%, and we passed that rate increase on in full to all of our variable rate savers.

The Group's trading performance against this market backdrop, including the impact on its KPIs, is covered in the financial performance section of this Strategic Report.

Competitive landscape

Technology is having a profound effect on consumer behaviour and the costs of providing services. Consumers are changing the way they interact with their banking providers, reflecting the way technology has made interaction easier in other markets. This means moving increasingly from transactions being made in branches to online and mobile devices, increasing use of brokers and intermediaries and more widespread use of price comparison websites[9].

New regulatory approaches, including simpler authorisation processes lowering barriers to entry and greater consumer use of technology-based banking, have helped a record number of new entrants to the market. This has added to pressure on margins, and competition is likely to accelerate in the future as the changes brought by the Competition and Markets Authority's Open Banking Remedy and the Second Payment Services Directive (PSD2) take full effect, creating new and innovative ways for consumers to use their financial data and opening the market to new platforms through which consumers can access goods and services. Open Banking is likely to accelerate the consumer migration away from traditional banking service provision through increased choice of provider and proposition.

The Group is responding to these changes in the competitive landscape primarily through its investment in its digital programme described further on page 26, and by its brand and distribution changes described on page 11.

Regulatory overview

A significant amount of new regulation is expected to impact the financial services industry over the next few years. Some of the key changes include:

- The new **General Data Protection Regulation** which comes into force on 25 May 2018. It harmonises data privacy laws across Europe and reshapes the way organisations across Europe approach data privacy. In the rapidly changing technology environment of today, the Group believes that an increasingly important part of building trust is safeguarding the information we hold. We started a programme in 2016 to ensure that the Group can address the impact of the new regulations. The Group has recently appointed a Data Protection Officer in response to the new data protection laws coming into force.
- **The Second Payment Services Directive**, which sets requirements for firms that provide payment services, and affects banks and building societies, payment institutions, e-money institutions and their customers. As well as promoting innovation, PSD2 aims to improve consumer protection, make payments safer and more secure, and stimulate competition in the payments market. The new regime came into force on 13 January 2018.
- The consultation on the extension of the **Senior Managers and Certification Regime** to the remaining PRA regulated firms and also to FCA solo-regulated firms[10]. Further detail on implementation is expected from the FCA in summer 2018, when the impact on the Group will become clearer.
- The **Fourth Anti Money Laundering Directive and Wire Transfer Regulations 2017**. These requirements were transposed to the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 and came into force on 26 June 2017. These have required some process changes for the Group to ensure it can comply with the new regulations.
- **Ring-fencing of retail banking activities**, which relates to the separation of retail banking activities and investment banking activities, mainly in larger institutions, and so has not had a direct impact on the Group.
- **Basel IV**, which relates to capital management and is likely to increase the level of capital requirements for many firms by implementing floors on the amount of capital that must be held by firms using the internal ratings based (IRB) approach to credit risk. This will impact the Group on obtaining IRB approval.
- The Bank of England's statement of policy on setting the **Minimum Requirement for Own Funds and Eligible Liabilities (MREL)**, which will have an impact in the medium-term on capital and wholesale funding requirements across the industry. Whilst full implementation has been pushed back to 2022 (with phased implementation from 2020), the requirement to hold either more capital or have access to debt that can be converted to capital will make the industry more resilient, but will increase costs of funding and capital.

The Group's position against these requirements is discussed more fully on page 34.

[9] 85% of UK consumers with access to the internet have used a digital comparison tool at least once, Competition and Markets Authority 'Digital Comparison Tools Market Study' (September 2017)

[10] Firms regulated solely by the FCA.

Strategy

Our story

We exist to provide real help with real life – that's what we've been doing for over 150 years.

Of course, the nature of real help has changed over this time - 150 years ago it meant making house purchase a reality for people that couldn't otherwise afford one. Today it is still about that and so much more - we strive to provide real help to more customers at moments that matter to them; starting on the property ladder, saving to provide for a family or other life event, making the most of their assets, considering retirement and creating their financial legacy for the next generation.

It also means helping communities to thrive, for example by supporting schools with financial education and using our colleagues' skills and expertise to promote community development, as well as supporting customers in more vulnerable situations.

As a building society we are set up specifically to help people rather than make money from them. That's every bit as relevant today as it ever was. That's because customers still need a home for their savings, and funding for their home, safe in the knowledge that they can trust us to act in their best interests not just today but also in the future. We provide great value and service not as a means to an end to make a profit for shareholders, but because that's the end in itself.

Our aim is to deliver real help with real life by being 'simply brilliant' in our core markets of mortgages and savings. We'll achieve this by focusing on our four strategic priorities:

Customer experience

Delivering a market leading customer experience built on empathy, simplicity and trust - we provide the kind of brilliant service we'd expect to receive ourselves.

People experience

Attracting and retaining the best talent, with a leading people experience built on our cultural foundation of 'mutual trust' - we work hard to be a brilliant employer because our people make YBS Group what it is, without them nothing would be possible.

Easy and simple

Delivering products, processes and systems for all our channels and brands that are easy and simple to use - we're simplifying our processes and policies, removing 'red tape' and unnecessary waste.

Business sustainability

Focusing on business sustainability, so that we are here for the long-term, providing a safe home for people's savings and making a lasting positive impact on society; that's why people trust us.

Being 'simply brilliant' will make us better at providing real help with real life, and that's how we will achieve our vision: to be the most trusted provider of financial services in the UK.

We measure progress against our vision through a survey which asks YBS Group customers whether 'YBS is an organisation you can trust', capturing the percentage who agree with the statement[11]. Our score has been above 55% and our rank among a peer group of competitors has been third for most of the year, against targets of 50% and fourth respectively. At 31 December 2017 we achieved a score of 58% and were ranked third.

An original home safe with its key

[11] YBS Brand Tracker, conducted by YouGov (data is on a three month rolling basis)

What makes us... us

Our values, developed and adopted by our people, were introduced in 2013. These are:

Customers at our heart

- We put ourselves in our customers' shoes at all times.
- We consider the customer's needs in every decision we make.
- We communicate clearly and simply and make things easy.

Personal

- We treat people as individuals.
- We treat people with warmth, decency and care.
- We listen and communicate clearly.

Passionate

- We love what we do.
- We approach our work with enthusiasm, pride and focus.
- We work together and combine our ideas for the best end result.

Trustworthy

- We keep our promises – we're honest and responsible.
- We're fair and approach everything with openness and integrity.
- If something goes wrong, we'll do everything we can to put it right.

Business model

Our business model is simple: we exist to provide a secure home for members to grow their savings, which allows us to lend to people to buy their own homes. This is our core business and our main focus.

We raise money through individuals who trust us to build their savings tailored to their goals. We raise about 75% of our funding this way, the rest is raised through wholesale markets, through government funding schemes or is provided by our accumulated reserves.

Once we have raised the funds, we lend it to individuals to buy their own homes, either directly through our branch network, agencies, telephone or online channels, or through intermediaries via Accord Mortgages Limited (Accord). We lend about 75% of our total funding this way. We also lend to individuals to invest in buy-to-let property (about 10%), to companies to invest in commercial property (about 2%) and to housing associations (about 1%). These business lines help support the Group's long-term sustainability through a profitable and stable income stream. The rest we retain as liquidity – cash to make sure we can pay our liabilities when they fall due.

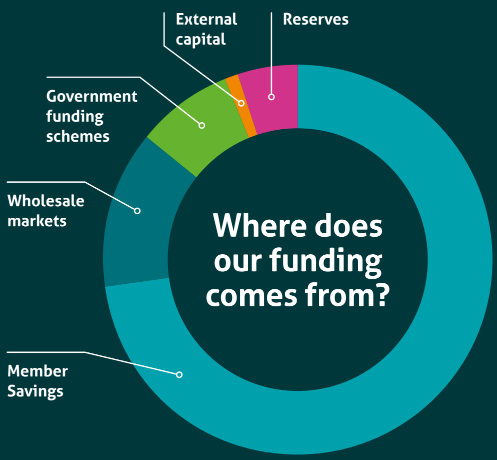
We charge interest on these loans to allow us to pay interest to savers and run the business. We also make income from other sources (employee savings and share schemes for companies through our Shareplans business, and a range of insurance products and services provided through trusted third party providers).

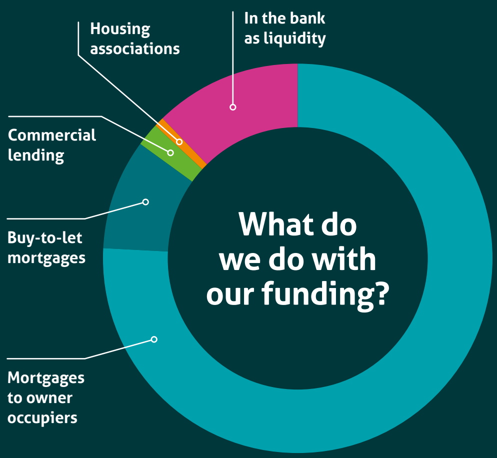
As a mutual organisation we set our profitability targets around being financially sustainable, and any additional profit after delivery of our products and services, and the costs of running the business, is invested in all areas of the Group's long-term sustainability:

- Protecting the financial position by building our capital strength.
- Investing in our future, through delivery of better products and services.
- Investing in our people, communities and social responsibilities.

Our strategy is built around being clear on exactly how we will invest those profits to meet our overall vision and purpose. We ensure we understand which parts of our business should drive commercial value, which potentially reduce the value we can give to members (which we should seek to minimise), and which parts should be invested in for the benefit of our members. In 2017 we started to make changes to our brand and distribution model which reflect this work, which are discussed more fully in the Chief Executive's introduction on page 9, and there will be further changes in 2018, as we aim to ensure that every pound we spend delivers maximum value for our members.

Our business model





How we generate income

- We generate income on the difference in interest rates received from borrowers, relative to that paid to savers
- We also receive interest on the money we keep in the bank, and pay interest on our sources of external funding
- We receive commission on third party products, such as insurance and later life planning services

Where our costs come from

- We spend money on running the business
- We put money aside for bad debt

What we use our profits for

- As capital to safeguard sustainability
- To reinvest in the business
- To provide benefits to customers through better products and services
- To provide benefits to the communities in which we operate
- We do not pay any of our profits away to external shareholders - every penny is reinvested for the benefit of members

Having customers at our heart means we can truly focus on providing real help for real life.

Trading performance

MORTGAGES

- **Gross lending: £8.1bn** (2016: £7.2bn)
- **Net lending £1.0bn** (2016: £0.7bn)
- **Market share (gross lending) 3.1%** (2016: 2.9%)
- **Mortgage balance growth 2.8%** (2016: 2.3%)

SAVINGS

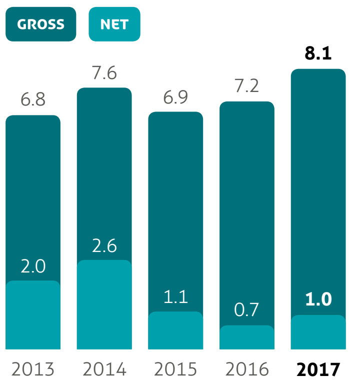
- **Retail savings balance growth 0.9%** (2016: 4.7%)
- **Retail savings outflow £0.2bn** (2016: £0.9bn inflow)
- **Average savings rate differential vs market average 0.28%** (2016: 0.38%)

All these performance measures are defined in the glossary on pages 184 to 185.

The competitive environment and economic uncertainty have created volatile trading conditions which we have managed in a sustainable and balanced way. Against this backdrop the Group has shown a solid trading performance, in line with its growth projections and its risk appetite.

There has been fierce competition in the mortgage market driven primarily by new players seeking to increase market share, and the impact of the TFS, which has provided low cost government funding for mortgage growth. As in previous years we have balanced the growth of the mortgage book with our ability to maintain savings rates in the ongoing low rate environment, whilst ensuring we do not attract more deposits than we can sensibly lend within our risk appetite.

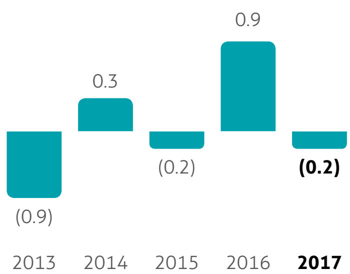
Gross and net lending £bn



Net lending has increased to £1.0bn in 2017 (2016: £0.7bn). This is a key measure of the Group's overall lending performance and represents gross lending less repayments of principal and redemptions. This measures our effectiveness in both new mortgage lending and in retaining borrowers. Gross lending has grown to £8.1bn (2016: £7.2bn), a 12.5% increase compared to 2016. This has been achieved by a combination of offering competitive rates in the market, expanded product propositions and improved service. The Group hit a new record of over £1bn of monthly mortgages applications in June 2017, a volume which has continued at similar levels since that point. This growth has been obtained within our risk appetite, with loan-to-value (LTV) mix broadly consistent - the average LTV of our new lending increased slightly in 2017 to 71.7% (2016: 69.9%), the overall indexed LTV of the Group mortgage book also showed a small increase, to 48.2% (2016: 47.7%). This is a key measure of risk as it represents the level of security provided for the loan. We have successfully increased our buy-to-let gross lending to £847m (2016: £807m), despite the significant reduction in the buy-to-let market since the tax changes of 2016. Our lending to first time buyers has remained stable at £1.3bn. Gross lending market share has increased to 3.1% (2016: 2.9%), with first time buyer market share stable at 3.3% (2016: 3.2%).

The Board monitors the Group's retail savings performance by tracking the net difference between retail savings deposits and withdrawals in any period – referred to as net retail inflow or outflow. Our overall retail savings portfolios had a net outflow of £0.2bn in 2017 (compared to an inflow of £0.9bn in 2016) with balances increasing to £28.9bn after interest capitalisation. This outflow was the result of a deliberate decision not to replace outflows from the brand and distribution changes we have made, given the additional unplanned savings growth experienced in late 2016.

Retail inflow/outflow £bn



We continue to offer average savings rates that are higher than the average for the rest of the market – the latest data available at the year end shows that our retail savings rates averaged 0.98% against a rest of market average of 0.70%, a difference of 0.28% (2016: 0.38%). This remains higher than our longer term target range of between 0.15% and 0.25%, reflecting our deliberate strategic decision to continue to minimise the impact of the low rate environment on our savings members as far as possible. However, this requires ongoing review to avoid excessive deposit inflow, since, whilst we aim to protect savers from the impact of low rates, we must ensure we do not attract more money than we can safely and sensibly lend. Surplus liquidity is held at the Bank of England at the Bank Rate which is much lower than the rates we pay our savers and so we need to manage our liquidity carefully.

We obtain the majority of our funding from retail deposits but also utilise the wholesale funding markets. We aim to optimise our mix of funding to balance:

- The impact on existing customers.
- The sustainability of the Group.
- Over reliance on one source.
- The level of liquidity we need to hold to ensure we meet our regulatory requirements and internal risk appetite.

Our overall funding mix also needs to be balanced against net lending in terms of overall level and term and future expectations. We have continued to utilise the government's FLS in 2017 and have also used the successor scheme, the TFS, to support our ability to offer good value mortgage and savings products.

On 2 November 2017, the Bank of England announced that the Bank Rate would increase with immediate effect from 0.25% to 0.50%, the first increase in Bank Rate for over 10 years. In response, the Group has passed on the full Bank Rate increase of 0.25% to all our variable rate savers and has aligned the mortgage SVR across all our Group brands to 4.99%, by passing on the full increase to the YBS SVR and reducing the Accord SVR by 0.35%.

The Group has passed on the full Bank Rate increase of 0.25% to all our variable rate savers.

Strategic areas of focus, including KPIs and progress

Progress towards the Group's Vision and Strategic Priorities is closely monitored through a set of KPIs reported to the Board monthly via a balanced scorecard which also reports on our current trading performance.

The table below provides a summary of performance against our top KPIs. These and other measures are covered in more detail in this report. All the performance measures in the table below are defined in the glossary on pages 183 to 187.

Scorecard category	KPI	2017 Actual	2017 Target	2016 Actual	Page
Vision 'To be the most trusted financial services provider in the UK'	Existing customers score (average for year)	58	50	57	14
	Existing customers rank (at year end)	3	4	2	14
Customer experience	KPMG Nunwood Customer experience survey result[12]	87th	Top 30	27th	20
	Net promoter score	+41	+35	+34	20
People experience	Best Workplaces survey result[13]	28th	Top 30	-	22
	Resignation rate	12.1%	<13.5%	11.6%	22
	Colleague engagement score*	68%	-	77%	22
Easy and simple	Cost:income ratio **	63%	71%	67%	32
	Customer feedback - simplicity	78%	74%	78%	27
Business sustainability	Common equity tier 1 capital ratio	15.8%	>13%	14.9%	34
	Statutory profit before tax	£166m	£132m	£152m	30
	Liquidity ratio***	15.7%	-	12.8%	33
	End Youth Homelessness fundraising****	£293k	>£260k	£320k	28
	Colleagues participating in volunteering	56%	50%	64%	28

Note:

*** There is no specific target set for the colleague engagement score. The Group aims to achieve as high a score as possible and to act on the results.**

**** The target is the plan figure for 2017. The medium-term target is a cost:income ratio of under 55%.**

***** Our liquidity is maintained at all times above our internal stresses and regulatory requirements rather than above a set percentage. This variable target was met at all times during 2017.**

****** 2016 comparative was for Marie Curie fundraising.**

[12] KPMG Nunwood Consulting – Nunwood Customer Experience Excellence Centre Top 100 UK Brands 2017, 295 participants were subject to the study but only the top 100 is published.

[13] The Best Workplaces survey is an external benchmarking exercise conducted by Great Places to Work®, involving an employee survey and a culture audit.

Customer experience

The Group aims to deliver the kind of brilliant service we'd expect to receive ourselves.

This means:

- Efficient, simple processes.
- A range of products and services that meet individuals' specific needs.
- Adapted support to customers in challenging situations.

Our key measure of performance of customer experience is our Net Promoter Score (NPS). NPS is a measure of how willing the Group's customers are to recommend the Group to others, and considers the experience of our customers across all brands and product lines, whether or not they have interacted with us in the period.

In 2017 we have developed this measure to incorporate the views of our intermediary network as well as the Group's mortgages and savings customers across all brands. I am pleased to report that our score on a like-for-like basis has risen from 34 in 2016 to 41 in 2017, recognising the developments we have made across all our product and service lines.

The annual KPMG Nunwood Customer Experience Excellence Survey for 2017 showed that the Group had fallen to 87th position (2016: 27th), out of 295 participants (2016: 287 participants). This was a disappointing result but reflected the impact of the brand and distribution changes, rather than branch service or satisfaction with colleagues, which remains high. Many key elements of our strategic change programme are targeted at improving customer experience in 2018.

+41

NET PROMOTER SCORE

In 2017 we have continued to develop our capability to identify and support vulnerable customers[14]. We have focused on developing excellent listening, questioning and empathy skills for all colleagues which will allow us to direct vulnerable customers to the right specialist support. We have established a Vulnerable Customer Panel, a group of experts in their areas specifically tasked with finding solutions to customer barriers.

The possible impact of the branch closures and the closure of the N&P current account we announced in early 2017 was a specific area of focus for us, to support particular customers who may experience vulnerability as a result of the closures. We worked closely with industry and regulatory bodies to ensure we took proactive steps to remove any barriers, including training our front-line colleagues to offer additional support and assistance.

We have also taken specific steps within the branch network, signing up to the Anchor 'Stand Up 4 Sitting Down' campaign to provide seating for the elderly and less able to enable them to access their high streets and shopping centres. We have also encouraged branch colleagues to undertake upskilling in subject matters that might support their local customer base.

For savings members we have renewed our annual Savings Pledges originally made in 2015. The six pledges build on our core value of 'customers at our heart' and detail what customers can expect from the Group as a savings provider. The Saving Pledges, which have been welcomed by our customers, are reviewed and updated regularly.

[14] A vulnerable customer is defined by the FCA as "someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care".

As part of these pledges:

- Customers can simply share their email address with us and be one of the first to hear about new savings accounts.
- If a customer sees an available savings account and goes on to book an appointment in a branch or agency to discuss it, then we guarantee the account will be available to them for the next 14 days, even if it is withdrawn from sale.
- Customers can make the most of their savings with a health check, to make sure they have the right savings account for their savings goal.

Many of our products are used by members to help them look after their loved ones. We have continued to build on this by partnering with specialist third parties to expand our offerings to include prepaid funeral plans, will writing services and legal assistance.

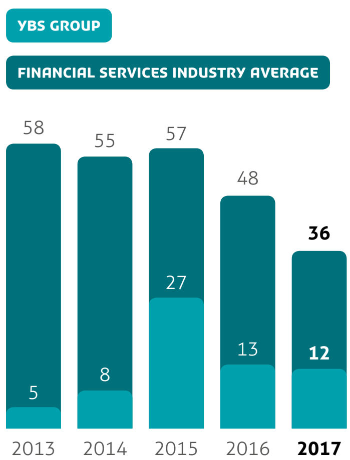
We aim to make sure the service that we provide is as good as it can be and of course ideally customers would not have cause to complain. Realistically, there are times when things do go wrong, and as a Group we pride ourselves on putting things right as quickly as possible. We measure the total volume of complaints we receive. Where we are unable to resolve the complaint internally and that complaint is referred to the Financial Ombudsman Service (FOS), we measure the instances where the FOS disagrees with our response and overturns the decision we made.

Data now available for the second half of 2017 shows that an average of 1.92 complaints was raised per 1,000 banking, savings and loan accounts and 12.23 complaints per 1,000 mortgage accounts (2016 H2: 1.55 and 13.50 respectively). Our internal analysis indicates the primary cause of the increase in savings-related complaints is the brand and distribution changes that have been carried out in 2017. The reduction in mortgage-related complaints reflects the ongoing improvements we are making to our mortgage processes.

In the first half of 2017 (the most recent data available), the FOS overturned our decisions in 12% of cases (H1 2016: 13%). This remains significantly below the industry average of 36%. This continued reduction has been a direct result of our ongoing activity to improve the way we handle complaints to really understand the cause of the complaint, allowing us to resolve it satisfactorily early in the process.

We will continue to provide great long-term value and service alongside help and support with key life moments.

FOS overturn rate %



* All figures are for the six months to 30 June to allow comparison to the available industry data

People experience

The Group believes that fundamental to delivering a great customer experience and ultimately delivering the Group's vision is a workplace where our people can give their best and thrive.

Consequently we invest significant effort into understanding what engages and motivates our colleagues in order to build both their commitment to and enjoyment of work. Our aim is to be a leading employer, where colleagues feel respected, valued and proud to work for us.

We do this by:

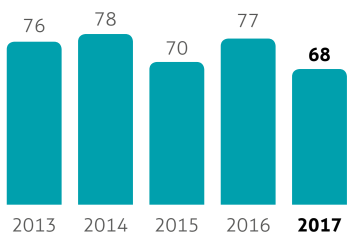
- Promoting a culture of supporting and engaging all colleagues, prioritising their wellbeing and promoting diversity.
- Providing opportunities and support for every colleague to develop and reach their potential, celebrating their successes along the way.

Colleague engagement

In our first year of entering, we've been recognised as one of the UK's Best Large Workplaces alongside a range of household names in the results published in 2017 based on surveys and research conducted in 2016.

There were two elements that came through strongly in the survey results: how welcoming and friendly our people are and the contribution we make through our charitable work and volunteering. In the survey, 90% of colleagues said that they felt good about the ways we support the community, and our Corporate Responsibility programmes were rated as "far above average" by the Best Workplaces research team.

Engagement %

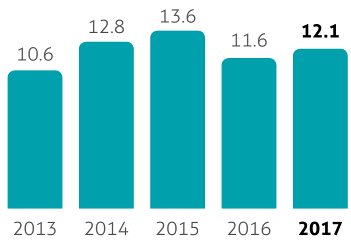


Note: The structure of the colleague engagement survey changed in 2016, hence the 2017 figures are not directly comparable with the 2016 position. The 2016 figure on a like-for-like basis was 75.

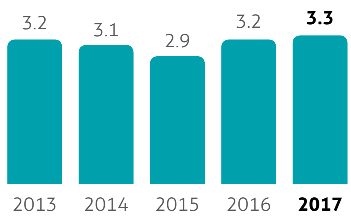
The results of the more recent survey conducted in 2017 has shown a fall in the engagement score, our key measure of overall people experience, from 77% in 2016's survey (75% on a like-for-like basis) to 68%. This still compares favourably to average engagement in Large Organisations (57%), despite the levels of change and uncertainty that many colleagues are currently experiencing following the brand and distribution changes and other efficiency initiatives. The feedback remained strong on teamwork, corporate responsibility, diversity and inclusion and we will focus on people experience as we continue to deliver our change programme.

The Group's other key performance indicators measuring the level of colleague engagement and satisfaction are the resignation rate and absenteeism rate. The resignation rate has increased slightly to 12.1% (2016: 11.6%), as has absenteeism at 3.3% (2016: 3.2%). Both remain within our target levels, despite the slight increases.

Resignation %



Absenteeism %



Inclusion

In 2017 we have increased our focus on diversity and inclusion.

We partnered with the National Centre for Diversity (NCfD) to help us to understand how well fairness, respect, equality, diversity and inclusion are embedded in the way we operate day-to-day. Since the appointment of a specialist Diversity and Inclusion Manager in late 2016, and the launch of our inclusion strategy in January 2017, we have raised awareness of these topics by delivering training events and workshops across the business. Our work engaging with the wider community included attending Bradford Festival and Leeds Pride over the summer months. In fact, our social media campaign #Prideinoursociety became our best performing social media campaign to date.

Our focus remains on building an inclusive workplace where everyone can not only be themselves but can also contribute and succeed. The NCfD has been so impressed with the progress we have made in 2017 that we have already been awarded conditional achievement of the Investors in Diversity Accreditation - Stage two, a year ahead of our target.

Our focus in 2018 is to build on the great progress achieved so far. Planned activities include improving the accessibility of our recruitment processes, providing our colleagues with multi-faith rooms (such as the modern facility opened in 2017 at our Bradford site), helping our key decision makers to identify their unconscious biases and of course, continuing to work towards Investors in Diversity full accreditation.

> In addition we have published our first Gender Pay Report in November 2017, referred to in more detail in the Directors' Remuneration Report on page 71.

BALANCE

Finding the balance

We understand our people have different lifestyles and responsibilities and we want to support everyone to find the balance between work and home life. Our new 'Finding the Balance' initiative launched this year reflects how we support managers and colleagues to find a balance that meets the needs of our business, our customers and our colleagues. We have enhanced the benefits we offer colleagues who take maternity, paternity, adoption or shared parental and carers/dependants leave. These changes have been recognised externally, with YBS being named as one of the UK's top 30 employers for working families[15], for our investment in family policies and our commitment to foster a flexible approach to the way we work.

Wellbeing

In 2017 the Group established a wellbeing programme that aims to help our colleagues to stay well and to support them in times of ill-health, focusing on both physical and mental health. Over 1,200 colleagues accessed this programme in its first year, obtaining support via our dedicated online resources or taking part in resilience sessions.

We've also signed the Time to Change Employer Pledge[16], as confirmation of what we've done so far and our commitment to changing the way we think and act about mental health at every level of our organisation.

We're committed to providing mental health awareness training for all colleagues, as well as a bespoke 'managing mental health at work' training programme for managers in conjunction with the Mental Health Foundation. In 2018 we'll also review our absence policy and procedures and continue to raise awareness of wellbeing and mental health across the Group.

Learning and development

In 2016 we successfully piloted our new apprenticeship programme, bringing in 12 new colleagues under the Trailblazer scheme. In 2017 we brought in twice as many apprentices across a variety of head office and branch locations and introduced internal apprenticeships to existing colleagues. In October, we were proud winners of the North East, Yorkshire and the Humber Regional Apprenticeship Award for 'Best Newcomer' and, in January 2018, our Apprenticeship Scheme was awarded the accolade of 'Best Newcomer Large Employer' at the National Apprenticeship Awards.

We continue to invest in developing the leaders of tomorrow. Our leadership programme, which provides our key talent with more confidence in their own abilities, promotes self-awareness and supports them to do things differently continues to grow, and in 2017 has started to include high-potential colleagues from a wider range of levels and roles. This includes the opportunity to study for the Building Societies Association Master's Degree in Leadership and Management in partnership with the Building Societies Association and Loughborough University.

In 2018 we will continue with our current modules, but also broaden this development into new areas, offering a Digital Leadership programme for the first time.

To support all colleagues' learning and development we introduced Academy Frameworks in 2017, which have been accessed by over 1,500 colleagues. These frameworks ensure our programmes, online learning, and other development opportunities are accessible and visible to all colleagues, facilitating more pro-active development planning. Built in conjunction with each business area, they are designed to mirror levels and capabilities within the organisation, covering both technical and behavioural learning.

In 2018 we will continue to expand and develop these frameworks to ensure that colleagues have access to appropriate learning to support them in realising their ambitions.

Recognition

Just as it's important to develop colleagues, we understand how important it is to recognise the great work that they do. We've continued to develop the range of tools available for colleagues, which include two formal schemes 'Raising the Roof' (which allows us to thank a colleague for going the extra mile for customers or colleagues) and 'My YBS Group Adventure', which celebrates key milestones through a colleague's career.

Receiving thanks from our customers is important to our colleagues; it helps them feel valued and recognised for the service they provide each day. So, in 2018 we're looking to launch a customer-to-colleague recognition scheme, which will allow us to showcase the customer feedback we already receive and encourage more customers to share their stories about our colleagues.

YBS Group has been named one of the UK's top 30 employers for working families.

[15] The Top Employers for Working Families benchmark was established by Working Families, a UK work-life balance charity, helping working parents and carers and their employers find a better balance between responsibilities at home and work

[16] Time to Change is a mental health campaign in England, with the objective of reducing mental health-related stigma and discrimination; time-to-change.org.uk

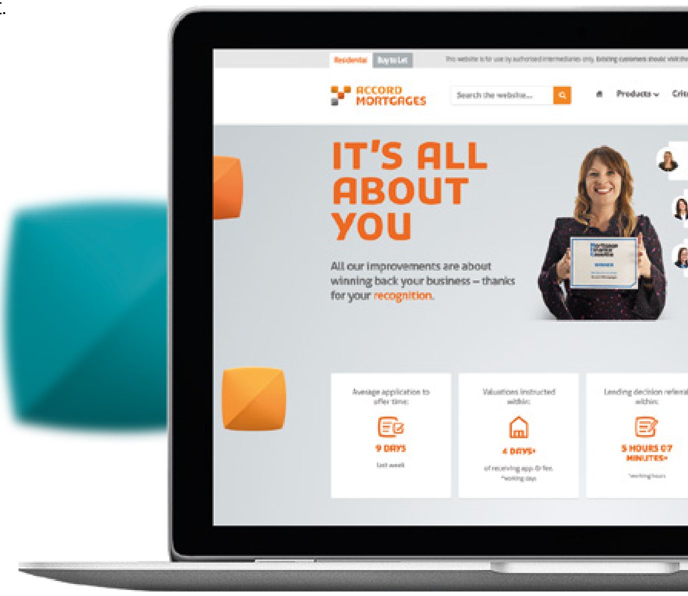
Delivery of change programme (easy and simple)

A core element of our investment programme is to make things easier and simpler both for our customers and our colleagues. We are progressing well with this programme with substantial delivery to date.

Key elements delivered in 2017 include:

- A number of system and process changes to make sure we are working towards being compliant with new regulatory requirements, including PSD2, GDPR and IFRS 9.
- A number of Individual Savings Account (ISA) improvements including automated ISA transfers and delivery of flexible ISAs. All of our YBS and CBS branded variable rate ISAs are now flexible, allowing customers to replace withdrawn funds without affecting their annual ISA allowance. This is targeted at improving our customer experience.
- **Digital capability improvements, including:**
  - Successfully increasing the proportion of direct lending originating through our website by simplifying processes, with the most significant improvements being for customers wishing to renew their mortgage with us. We have also improved the process for prospective borrowers through changes to our 'borrowing calculator', especially for mobile users.
  - Setting up the majority of our product range so that accounts can be managed online and improving the registration process, giving over 600,000 savers access to their accounts online and allowing them to combine their branch experience with remote account management on an ongoing basis.
  - Investing in our mobile experience to improve account accessibility via mobile devices.
  - Enhancing website content to provide a practical guide and help for customers at different stages of their financial lives.
  - Relaunching the Accord website to improve online experience for our broker partners.

  The digital enhancements primarily target our 'easy and simple' and customer experience strategic priorities, by making our processes more efficient and easier to navigate for customers or broker partners.
- Delivery of a number of improvements to our Shareplans offering, including the facility for customers to sell shares, same-day trading and further improvements to the Shareplans facilities available to international customers.
- Continued investment in our mortgage systems, including delivery of changes which enabled successful re-entry to the interest only market via Accord at the end of November. The changes implemented have allowed us to maintain our focus on customer experience and have contributed to the improvements in NPS described earlier in this Strategic Report.
- Key milestones required for our IRB capital requirements project. We intend to make an application to the regulatory authorities for IRB status in 2018. This provides us with greater capability in understanding our underlying business and making decisions based on risk, which will improve our business sustainability.
- Ongoing work to improve our analytics capability. This included delivery of a data cleansing capability to ensure data quality is maintained and delivery of industry standard processes to be followed for all change activities to ensure that data related change is executed consistently across the Group. It also included improvements to the Group's ability to establish and manage financial hedge relationships, including improved management information. This enhances business sustainability by improving efficiency of reporting and by ensuring decisions are based on good quality data.



The main projects we will be working on in 2018 are:

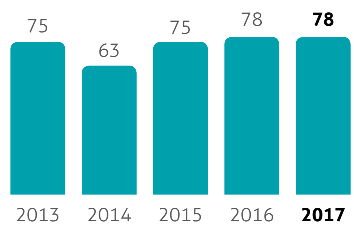
- Continued delivery of changes to ensure that we have implemented new regulatory requirements appropriately.
- As previously noted, as part of our focus on efficiency, we plan to complete the closure of the N&P current account, N&P personal savings accounts will be transferred to YBS products and the remaining N&P branches will rebrand to YBS, giving all retail customers access to the full YBS branch network to manage their accounts.

We will invest in our mortgage programme as a priority, focused on delivering an exceptional service for customers and brokers...

- We will invest in our mortgage programme as a priority, focused on delivering an exceptional service for customers and brokers, generating further efficiencies and developing the capability to deliver mortgage offers more quickly. This will start with enhancements to product functionality on our new interest only product and developments into potential new mortgage product areas. Alongside these product launches we will continue to build and integrate our new mortgage platform, with associated process and policy redesign to create a strong foundation for the future of our mortgage lending.
- Further investment to maintain our ability to prevent, detect and manage financial crime and fraud. This is particularly important as the nature of fraud related threats is constantly evolving, and as our customers change the way they interact with us, moving increasingly to digital channels. Ensuring we maintain our focus on fraud prevention and detection protects our customers and helps safeguard business sustainability.
- Further investment in our data infrastructure to underpin improved management information, continuing the progress made in 2017. This will underpin rapid and effective decision-making at all levels of the business.
- Further investment in our digital capability, adapting our business to ensure we continue to meet customers' evolving needs, including better integration of our online platform with other channels to offer improved multi-channel interaction, and seeking opportunities provided by open banking to provide new products and services for our customers.

Our primary measure of ease of interaction with the Group is the simplicity score, which captures the proportion of positive responses to the survey question "YBS Group is simple to do business with" across all core areas of the Group, capturing both broker and customer feedback. In 2017 we have maintained this in the range 77%-79% consistently throughout the year (2016: 78%).

Simplicity %



Business sustainability

We believe that there are two key components to being a sustainable business:

- Being financially secure, so that our members can rely on us being here for the long-term. This element is covered under the Financial performance section which starts on page 30.
- Having a positive and meaningful impact on the communities we serve and wider society.

Colleague volunteering

We aim to be an active member of the communities we serve, using our expertise, passion and scale to maximise our impact. In 2017 56% of our colleagues made use of their 31 hours volunteering allowance to share their skills and make a difference to charities and other good causes.

We believe financial literacy education and employability skills are crucial to help young people build their futures and during 2017 we have continued to grow and develop our Money Minds financial literacy programme, covering topics such as teaching young children how to keep money safe and teaching older students how to buy a house or save towards a pension. We will continue to develop this programme in 2018.

Our Make the Grade programme aims to raise aspirations and improve the future employability of students, to prepare them for life after school. During 2017 we expanded the programme to work with more secondary schools in Yorkshire. We introduced new programmes including careers panels and experience days, where colleagues deliver fun and interactive workshops about the world of work.

2017 marked our third year of mentoring Leeds University Business School students, providing regular coaching and support, and we have expanded this to the University of Bradford in September 2017.

Across the UK, over 1 million people go a month or more without seeing or speaking to a friend, family member or neighbour[17]. Using the fantastic listening and interpersonal skills developed in their day-to-day roles, YBS colleagues continued to make calls to their Silver Line[18] Friend throughout 2017, where colleagues are matched with an isolated older person and call them once a week for half an hour.

End Youth Homelessness – success so far

In 2017 we launched a new three-year partnership with End Youth Homelessness (EYH) to break down the barriers that homeless young people face, challenge preconceptions of youth homelessness and support 700 young people to move into their own home. This charity was selected following votes from both colleagues and customers.

Colleagues and customers raised more than £293,000 in the first year of the partnership.

Our bespoke Rent Deposit Scheme with EYH has so far helped over 50 young people make the step to living independently, also offering them a £200 grant towards essential household items. During their tenancy young people also benefit from dedicated support with their finances, confidence, life skills and budgeting.

During the partnership we aim to deepen understanding of youth homelessness and build engagement in supporting homeless charities among our colleagues and customers. Colleagues have given extra support by donating over 3,800 hours of volunteering time to support EYH member charities and together with our members have collected warm clothing and toiletries worth over £18,000 to support young homeless people.

Environment

At YBS Group we are working to reduce our environmental footprint, through responsible procurement and reduction of our impacts across energy and water consumption, travel and waste, and through raising awareness and understanding of environmental risks and opportunities amongst colleagues and customers.

Some of the achievements in 2017 include:

- Reducing our carbon footprint by 19% compared to 2016 through a range of energy efficiency initiatives in our head office locations and branch network and by the reduction in size of the branch network. In 2018 we are looking to trial adding solar film, a thin heat reflective laminate, to the windows in our Bradford office, in order to reduce internal temperatures and lessen the need for air conditioning.
- Continuing to work with colleagues to raise awareness of environmental matters through various campaigns, such as Fairtrade Fortnight, Bike to Work week, National Liftshare Week and World Environment Day. Over 500 colleagues are registered to car share and over 260 colleagues have taken up the Cycle to Work scheme across the Group.
- Our colleagues supporting environmental initiatives away from work via our volunteering programme, such as helping to clear debris, gardening and tree felling to provide varied habitats for wildlife at various locations near our office sites.

[17] Age UK - 'No one should have no one at Christmas' (2017). Available from: ageuk.org.uk/northyorkshire/z/news--campaigns/no-one-should-have-no-one-at-christmas/

[18] The Silver Line is the only free confidential helpline providing information, friendship and advice to older people, open 24 hours a day, every day of the year; thesilverline.org.uk

SUPPORT

£293,000
End Youth Homelessness fundraising
(2016: Marie Curie fundraising £320,000)

56%
% colleagues participating in volunteering (2016: 64%)

The performance measures above are defined in the glossary on page 187.

Financial performance

In 2017 the Group recorded another year of strong financial performance, with healthy profit underpinned by continued strong capital and liquidity positions.

STATUTORY PROFIT BEFORE TAX	CORE OPERATING PROFIT	COMMON EQUITY TIER 1 (CET1) CAPITAL RATIO	LIQUIDITY RATIO	COST:INCOME RATIO
£166m	**£160m**	**15.8%**	**15.7%**	**63%**
(2016: £152m)	(2016: £128m)	(2016: 14.9%)	(2016: 12.8%)	(2016: 67%)

The performance measures above are defined in the glossary on pages 183 to 187.

As the KPIs show, 2017 has been a year of strong financial performance. We have outperformed our plan performance in a number of areas, continued to invest in our change programme and improved our financial position compared to 2016, despite the competitive trading environment.

The Board monitors the Group's performance on both a statutory profit before tax and core operating profit basis. Statutory profit before tax is defined by accounting regulations and provides a clear comparison between organisations. Core operating profit measures underlying performance by excluding non-core items, both positive and negative, such as timing differences that reverse over time (e.g. fair value adjustments) or items of a one-off nature (e.g. asset sales). For this reason, the Board considers core operating profit to be a more appropriate measure of underlying Group performance than statutory profit before tax.

Statutory profit before tax for 2017 was £166m (2016: £152m). Our core operating profit was £160m (2016: £128m). This strong financial performance enabled us to improve our key measure of financial sustainability and our CET1 ratio, described more fully on page 34.

Group Income Statement

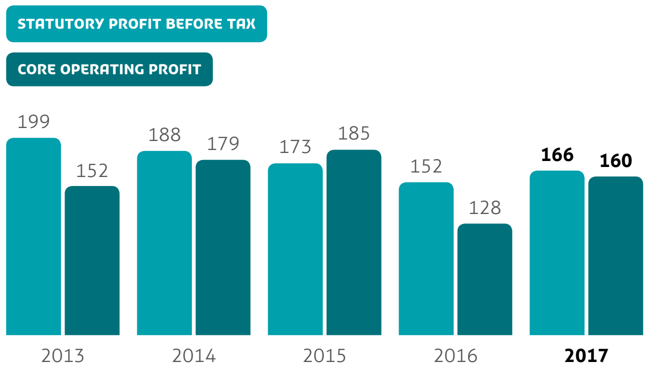
£m	2013	2014	2015	2016	2017
Net interest income	532	549	535	476	502
Fair value volatility	16	(11)	(7)	1	13
Net realised gains/(losses)	(42)	1	2	2	6
Other income	37	26	18	36	15
Total income	**543**	**565**	**548**	**515**	**536**
Management expenses	(300)	(331)	(346)	(346)	(340)
Operating profit before provisions	**243**	**234**	**202**	**169**	**196**
Loan loss provisions	(23)	(20)	(13)	-	10
Other provisions	(21)	(26)	(16)	(17)	(40)
Statutory profit before tax	**199**	**188**	**173**	**152**	**166**

£m	2013	2014	2015	2016	2017
Statutory profit before tax	**199**	**188**	**173**	**152**	**166**
Reverse out					
FSCS levy	12	12	11	5	2
Non-core investments	(14)	(11)	1	(1)	(6)
Timing differences - fair value volatility	(2)	22	6	(1)	(7)
Mergers - adjustments to balances acquired	(94)	(32)	(4)	(3)	(4)
Mergers and acquisitions - costs	2	-	-	-	-
Mortgage book disposal	13	-	-	-	-
Balance sheet structured debt buy back	30	-	-	-	-
Restructuring provision	-	-	-	-	14
Other non-core items	6	-	(2)	(24)	(5)
Core operating profit	**152**	**179**	**185**	**128**	**160**

The items reversed out in calculating core operating profit include:

1. The FSCS levy (£2m) which is our share of the overall cost of funding failed institutions through this scheme. This is excluded from core operating profit as it does not represent part of the Group's underlying performance.
2. An improvement in the market price of one of our non-core assets in our structured credit portfolio prior to its maturity in 2017, which realised a gain of £6m. As structured credit investments are no longer part of our liquid asset investment strategy, these are deemed non-core and hence any gains or losses are excluded from core operating profit.
3. Fair value volatility (£7m) which reflects changes in market rates on some of our assets and liabilities. These are mostly timing differences which will reverse in time.
4. The release of fair value adjustment made on merger for the provision of expected lifetime losses (£4m).
5. Charge of £14m for restructuring costs expected to be incurred as a result of the business and organisational changes announced in 2017.
6. Profit from the sale of properties (£2m) and shares (£3m) that we would not expect to see on an ongoing basis. These are one-off in nature and therefore excluded from core operating profit.

Statutory profit before tax / Core operating profit £m

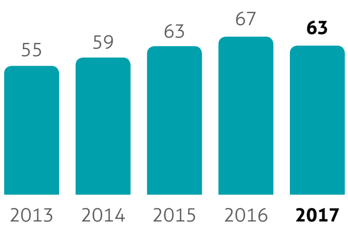


The key movements and trends within the Income Statement were as follows:

- Net interest income was £502m (2016: £476m). At 1.23% (2016: 1.22%) net interest margin was broadly stable. This is a key measure used by the Board to monitor how the Group has managed the income from its assets and interest paid on funding. The main factors impacting this through the year include:
  - A reduction in mortgage margins, driven by:
    - The competitive trading environment and falling interest rates on new products, meaning new products earn lower margin than historic ones.
    - Increased remortgage activity within the mortgage market more widely, leading to increased transfer and redemption activity both from customers within their product term and those on SVR.
  - The continuing availability of low cost funding, both in the savings market and the wholesale funding markets, both of which continued to be impacted by the government's funding schemes in 2017.
- Fair value volatility represents adjustments to the value of some of our assets and liabilities to reflect changes in underlying market rates. These are almost entirely timing differences which will reverse in future years as the assets and liabilities themselves mature. As such this figure could move materially year on year, and we aim to minimise its impact. In 2017 this figure has been significantly impacted by the unwinding of previous adverse movement in value of one of our remaining structured credit investments as it neared its maturity date in 2017.
- Net realised gains and losses include profits from the sale of gilts of £6m.
- Other income has reduced to £15m from £36m in 2016. The 2016 figure included £24m of one-off gains arising from the sale of branch properties (£12m) and the Group's benefit from its shareholding in Visa Europe following the latter's acquisition by Visa Inc. (£12m), which were excluded from our core operating profit. The equivalent level of one-off items in 2017 excluded from core operating profit (described under point 6 above) was £5m. Underlying other income is broadly stable.
- Management expenses reduced by £6m to £340m (2016: £346m). The figures impacting this included:
  - Continued investment in our change programme. In 2017 we spent a total of £73m (2016: £75m) on our change activities, of which £66m (2016: £66m) was charged to the income statement. We expect that change-related expenditure will continue to decrease over the coming years.
  - A reduction in staff costs as a result of our efficiency initiatives, including process improvement activity and the branch closures carried out in 2017.

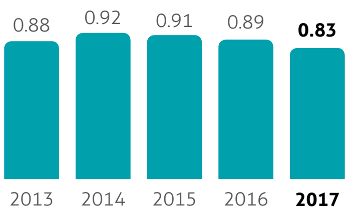
A key measure used by the Group to monitor and manage its overall cost position is the cost:income ratio, which looks at the relationship between the income we generate and our costs. The lower the ratio, the less an institution is spending to generate every pound of income. As income has increased and costs decreased in 2017, the cost:income ratio has also decreased, from 67% in 2016 to 63%.

Cost:income ratio %



The Group also measures its overall cost efficiency via the management expenses ratio, which measures the Group's costs as a proportion of its mean assets during the year. This ratio has also decreased in the year to 0.83% (2016: 0.89%).

Management expenses (cost to mean assets) %



Provisions

The charge for impairment on our loan portfolios fell from £nil in 2016 to a release of £10m in 2017, reflecting the continued improvement in the Group's mortgage arrears position and the release of a provision held against the N&P current account book no longer required.

The charge for other provisions increased to £40m in 2017 (2016: £17m). The main drivers of this increase are:

- A £19m charge for Payment Protection Insurance (PPI) (2016: £10m). This is due to an increase in expected claims arising from the FCA's confirmation of the formal deadline for submitting claims and announcement of the publicity campaign running up to that deadline. It is also driven by the new rules and guidance arising from the Supreme Court's decision in the case of Plevin v Paragon Personal Finance Limited (Plevin), which expands the scope of potential claims.
- A £14m restructuring provision charge for the business and organisational changes announced in 2017.
- An increase in the charge for onerous leases to £5m (2016: £2m) relating to branches that have been closed, but where we still have a lease in place. This is largely offset by a fall in provisions for the cost of the FSCS whereby we, and other retail savings institutions, fund the wind down of a number of failed institutions. This charge of £2m in 2017 (2016: £5m) reduced mainly as a result of the sale by UK Asset Resolution Limited of parts of the Bradford and Bingley plc mortgage portfolio in 2017.

Taxation

The Group's tax charge for the year of £41m (2016: £37m) represents an effective tax rate of 25% (2016: 25%), which is higher than the UK statutory corporation tax rate of 19% (2016: 20%). This is primarily due to a charge of £6m (2016: £4m) in respect of the banking surcharge which is charged at a rate of 8% on the Society's taxable profits above £25m and the tax effect of disallowable customer redress costs of £18m (2016: £15m).

Group Balance Sheet

£bn	2013	2014	2015	2016	2017
Liquid assets	4.4	4.8	4.4	4.7	6.1
Mortgage and other loans	29.5	32.2	33.3	34.1	35.1
Other assets	0.6	0.6	0.5	0.8	0.8
Total assets	**34.5**	**37.6**	**38.2**	**39.6**	**42.0**
Retail savings	26.3	27.2	27.4	28.7	28.9
Wholesale funding	5.9	7.5	7.9	7.9	9.8
Other liabilities	0.4	0.6	0.5	0.5	0.3
	32.6	**35.3**	**35.8**	**37.1**	**39.0**
Remunerated capital	0.1	0.3	0.3	0.3	0.6
Reserves	1.8	2.0	2.1	2.2	2.4
Total equity and liabilities	**34.5**	**37.6**	**38.2**	**39.6**	**42.0**

Overall balance sheet growth has been driven by a combination of 3% growth in loan assets and increased liquidity, as the Group sought to participate in the TFS to finance mortgage lending in 2018.

On the funding side, whilst retail savings balances have increased by £0.2bn, our growth has primarily been in wholesale funding (including the government TFS), in line with our diversified funding strategy, and also through the issuance of £300m of Tier 2 capital. At the end of 2017, 90% (2016: 92%) of mortgages were funded by retail savings and retained profits.

The other assets figure for 2017 includes an asset in respect of the Group's defined benefit pension scheme of £95m (2016: £42m).

Movements in the assets and liabilities of the scheme are explained in Note 26.

The main reasons for the increase are a greater number of leavers from the Group who are members of the scheme, and higher asset returns than predicted.

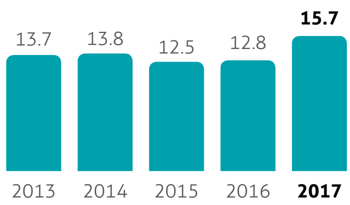
Liquidity and wholesale funding

One of the key measures that we are required to report to the Prudential Regulation Authority (PRA) is the liquidity ratio. This expresses the total cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets as a percentage of our shares and borrowings. It is inefficient to hold significantly more liquidity than is required as, in general, excess liquidity earns less than it costs to fund. For this reason the Group seeks to maintain prudent but not excessive levels of liquidity, to manage risk whilst optimising the cost of holding it. Throughout the year we remained above the liquidity thresholds set by the PRA (and by our own stress testing models).

In support of a diversified funding programme, we have continued to participate in the wholesale funding markets in 2017, with successful issuances in both the covered bond and the residential mortgage backed security (RMBS) markets.

At the end of 2017 our liquidity ratio was 15.7% (2016: 12.8%). This elevated level reflects our use of the TFS described earlier as a low cost funding source to support lending in early 2018.

Liquidity %



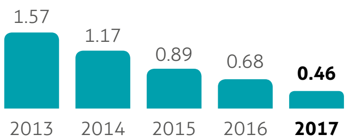
Arrears

The quality of our mortgage portfolio is monitored by management and the Board on a monthly basis using a number of indicators. The most important indicator is the percentage of outstanding retail mortgage balances in arrears by three months or more (including possessions). The value of such loans reduced to 0.46% at 31 December 2017 (2016: 0.68%).

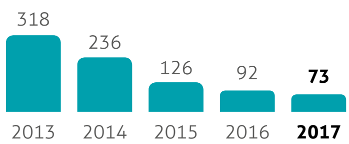
The industry average for mortgage arrears is measured as the number of accounts more than three months in arrears (including possessions). At 0.56% (2016: 0.76%) our performance remains below the industry average of 0.88%[19] (2016: 0.95%).

At 31 December 2017 the Group had a total of 73 retail mortgage properties in possession (2016: 92). The amount written off our loans and advances to customers in 2017 was £4.7m (2016: £6.3m). The graphs illustrate the consistent and sustained improvement across all these key credit risk indicators, and this combination of falling arrears, properties in possession and write offs reflect the low risk appetite the Group has set on our lending activities.

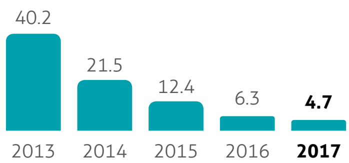
3 Months arrears %



Number of retail mortgage properties in possession



Retail mortgage write offs (£m)



Capital

As noted earlier in this Strategic Report, we have continued to build on the financial sustainability of the Group by increasing the CET1 ratio. This ratio represents the relationship between our strongest form of capital (accumulated profits that have built up over time) and our assets, weighted by the level of risk they carry.

As at 31 December 2017

- Our CET1 ratio was 15.8%, increasing from 14.9% at the end of 2016.
- Our total capital ratio increased from 17.3% in 2016 to 20.1%.

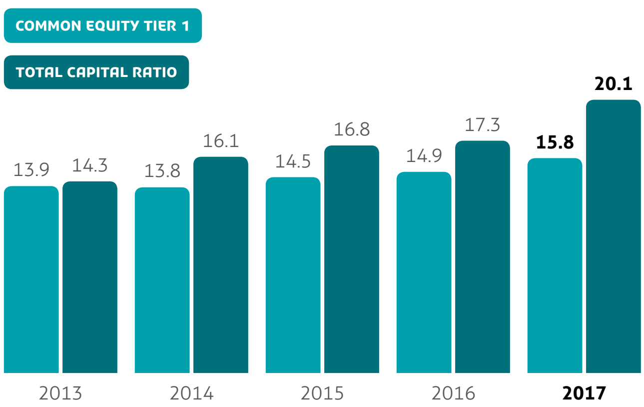
The Bank of England's statement of policy on setting the MREL will be fully implemented in 2022, with phased implementation from 2020. This will require banks and building societies to hold more capital, or debt that can be converted to capital. The Group is well positioned to meet these requirements, and in support of the implementation of this new regulation, has issued £300m of Tier 2 capital in September 2017 which is also eligible capital for meeting our total capital ratio requirements.

The leverage ratio provides another measure of our capital position. This measure compares capital with total assets, by removing the risk weighting used in the CET1 ratio and adding a measure of off balance sheet exposures to the asset side of the equation, requiring capital to be held against items such as mortgage offers that have yet to complete. At the end of 2017 our leverage ratio increased to 5.7% (2016: 5.1%). This calculation now excludes assets held at central banks from the leverage balance sheet. On a like-for-like basis, the Group's 2016 leverage ratio would have been 5.6%.

The leverage ratio is not currently a mandatory measure for the Group, but we are already well above the minimum regulatory requirement of 3.25% (this was increased by the PRA from 3.0% in 2017).

Our leverage ratio, expressed using the definition of eligible liabilities consistent with MREL definitions and using the definition of assets which excludes cash held at Bank of England, was 7.2% at the end of 2017.

Capital ratios %



19 Source: UK Finance (December 2017)

Principal risks and uncertainties

The Group's risk profile changes as we move through the economic cycle, and the areas of the risk framework that currently impact the Group most significantly, and the way in which the Group mitigates these, are described more fully in the Risk Management Report which starts on page 61, and are summarised below:

Risk	Principal mitigation	KPI 2017 status vs 2016
Retail and commercial credit risk	The Group sets a risk appetite for its retail and commercial lending activities which limits exposure to higher risk lending areas, and monitors adherence to this.	**Improving** (Page 65)
Wholesale credit risk	The Group sets a risk appetite for wholesale credit risk and monitors adherence to this. It adopts a low risk approach to wholesale credit, investing most of its liquidity in the highest quality assets.	**Improving** (Page 65)
Funding and liquidity risk	The Group sets a risk appetite, and stress tests its positions against this risk appetite. The Group operates a diversified funding base, primarily through retail savings, supported by a strong wholesale funding franchise.	**Improving** (Page 66)
Market risk	The Group adopts a low risk approach to market risk, and stress tests all positions against a range of scenarios.	**Stable** (Page 67)
Operational risk	The Group operates an internal control framework in line with the Board risk appetite and monitors adherence.	**Improving** (Page 68)
Compliance and conduct risk	The Group operates an internal control framework in line with the Board risk appetite and monitors adherence.	**Stable** (Page 68)
Business risk	The Group maintains a capital risk appetite and regularly stress tests its positions against severe scenarios.	**Improving** (Page 69)

The Group recognises that the environment within which it operates and the nature of the threats which it faces are continually evolving. Consequently, the Group continues to invest in its risk management capability in order to ensure that emerging and evolving risks continue to be closely monitored and that timely and appropriate action is taken to protect the interests of the Group and its customers. Significant emerging risk headwinds are regularly reviewed through the senior risk committees and are considered as part of the Group's planning process, as they have the potential to impact the Group's strategy most materially.

The most significant risk environment headwinds currently facing the Group can be summarised as follows:

Macroeconomic (business risk)

- **Political uncertainty in the UK**

  Notwithstanding some market volatility in the immediate aftermath of the vote to exit the EU, the UK financial system has remained stable. However, there remains a risk of significant disruption to the UK economy which we will closely monitor.

- **Market pressures on core business**

  Despite the UK interest rates rising for the first time in over ten years in November 2017, sustained historically low interest rates continue to constrain margins and the issue of affordability is fundamentally changing the housing market. Pressure upon disposable incomes is reflected in falling rates of saving. As a result, growth opportunities may yet prove elusive within the Group's core markets and the Group's business model potentially impacted.

- **Deterioration in the global economy**

  Geo-political uncertainty coupled with a continued slowdown in the emerging economies, may in turn impact growth in the UK and delay the expected increases in the Bank Rate.

Financial crime and cyber security (operational risk)

- **Rapidly evolving financial crime threats**

  Recent events continue to illustrate the hostile nature of the environment within which the Group operates. Ongoing focus on the Group's financial crime capability and investment remain paramount in order to keep rapidly evolving financial crime exposures within the Group's risk appetite.

- **New and evolving cyber security threats**

  The increasing use of technology and the pace of technological change expose the UK financial services sector to ever increasing and evolving cyber security threats. Resilience to such threats and an ability to effectively respond in the event of an attack are essential in order to protect the Society, maintain the trust of our customers and the confidence of our regulators.

Operational failure (operational risk)

- **Ensuring the provision of resilient services**

  Traditionally, resilience has largely referred to the ability to recover from an incident in the shortest time possible. However, customer (and regulator) expectations are now such that any interruption in service may result in significant reputational damage. Consequently, resilience must form an integral part of any new service provision.

  Maintaining and enhancing resilience controls will safeguard the Group's reputation, meet the expectations of regulators and avoid or reduce the costs associated with service failures. However, the continued provision of a highly reliable service, coupled with the need to effectively respond to customer expectations may mean that maintaining IT systems and infrastructure becomes increasingly time-consuming and expensive.

Legal & regulatory compliance (business risk)

- **Changing regulatory landscape**

  Compliance and conduct is central to the Group's values and behaviours. It is recognised that ongoing focus is required to ensure the Group continues to encourage robust challenge and keeps pace with the rapidly changing technological and globalised legal and regulatory environment.

- **Change outpacing regulation**

  The rapidly changing technological environment and associated demands and expectations of our customers, may mean that industry developments need to be progressed ahead of regulatory change. This may result in uncertainty and require careful management in order to ensure that fair customer outcomes continue to be delivered.

Changing market for financial services (business risk)

- **Increased competition from established and new firms**

  The activities of challenger banks and Financial Technology firms within the context of 'open banking' may impact product pricing and erode margins. At the same time, the creation of ring-fenced commercial banks ahead of 2019 will necessarily create greater focus and resultant increasing competition within the Group's core markets.

- **New technology and weaknesses in core capabilities**

  The digital transformation is gathering momentum and will accelerate changes in customer expectations. The Group's ability to respond effectively will largely be dependent upon its risk management capabilities, which may require significant strengthening across certain risk categories, e.g. information management, change management and third party risk. The cost of delivering the level of change necessary to keep pace with rapidly changing technology may also prove unsustainable and require investment choices which may not fully meet these expectations.

Outlook

We have already referred to many of the external factors that may impact the Group in the next few years. Political and economic uncertainty will no doubt continue to be a significant factor long beyond the date currently set for the UK's exit from the EU in March 2019, and the economic outlook for the UK will depend on how the terms of the exit are finalised. The direct impact of the exit on the Group is expected to be limited, with the key uncertainties being the more general impact on the UK economy.

The pace of technological change, partly driven by regulation, is influencing customer demand and all financial services providers will need to adapt to how the market changes in the coming years to continue to be successful. We will be focused on balancing the face-to-face channels that our customers value with the rapidly increasing importance of digital channels.

The Board believes that 2017 has been a good year with a strong financial performance and significant progress on our efficiency programme, which will position us well for the future, as well as continued improvement in our service and product offerings. We believe that 2018 and beyond, whilst presenting challenges to the Group along with the rest of the market, will see us build on the efficiencies and improvements we have made and expand them further, whilst as always making sure we are a sustainable business, here for the long-term.

Viability and going concern

The Directors confirm that they consider that the Group has adequate resources to continue in existence for at least 12 months from the date of signing these financial statements, and so the requirements of the principles surrounding going concern accounting requirements can be met. This confirmation is made after having reviewed assumptions about future trading performance, liquidity requirements, capital requirements and sustainability contained within our Corporate Plan. The Directors also considered potential risks and uncertainties in business, credit, market and liquidity risks, including the availability and repayment profile of funding facilities. Based on the above, together with available market information and the Directors' knowledge and experience of the Group and markets, the Directors continue to adopt the going concern basis in preparing the accounts for the year ended 31 December 2017.

For the purposes of the viability statement the Directors have determined three years to be the most appropriate period to consider as this covers the typical term of a large proportion of our products and is the longest period over which the Board considers that it can form a reasonably firm view over the possible macroeconomic environment and associated key drivers of business performance.

The Directors have assessed the viability of the Group over a three year period to December 2020, taking account of the Group's current position and the potential impact of the risks documented elsewhere in the Strategic Report. The Group's financial planning process comprises a budget for the next financial year, together with a forecast for the following four financial years. Achievement of the one-year budget has a greater level of certainty and is used to set near-term targets across the Group. Achievement of the five-year corporate plan is less certain than the budget, but provides a longer term outlook against which strategic decisions can be made.

The financial planning process considers the Group's profitability, capital position, liquidity and other key financial metrics over the period, including impending regulatory changes such as MREL. These metrics are subject to sensitivity analysis through the annual Group ICAAP (Internal Capital Adequacy Assessment Process) and ILAAP (Internal Liquidity Adequacy Assessment Process). The Group stresses its capital and liquidity plans, respectively under 'severe but plausible' stress test scenarios, in line with PRA requirements.

The ICAAP stress test ensures that the plan projections for capital requirements and capital generation are resilient to stresses should the environment deteriorate beyond the levels currently envisaged. The resulting potential erosion in the capital excess is held on the balance sheet as a capital planning buffer to ensure that the Group can continue to meet its minimum capital requirements at all times. The ILAAP stress test ensures that the Group holds adequate liquid assets in terms of both quality and quantity sufficient to meet both its business as usual liquidity needs and any increased requirement that could occur as a result of the Group entering into a period of stress. Planned liquidity levels meet the Group's key risk appetite measures over a period of three years.

The Board has undertaken a robust assessment of the principal risks and uncertainties that could threaten the business model, future performance, solvency or liquidity of the Group. These risks are described on page 36 of this Strategic Report and in the Risk Management Report which starts on page 61. The Group's risk management framework and governance structure are described in the Risk Management Report.

Based on the assessment set out above, the Directors have a reasonable expectation that the Group will continue in operation and meet its liabilities as they fall due over the period to December 2020.

Alasdair Lenman
Chief Finance Officer

28 February 2018

A closer look at your board members

Non Executive Directors

John Heaps LLB
Chairman

Joined the Board in 2014 as Chairman Designate, becoming Chairman in 2015.

Background and career

As a qualified lawyer, John worked in the legal profession for 40 years, joining the senior management team of the corporate law firm Eversheds in 1999. He was appointed Chairman of Eversheds in 2010 for a four-year term and retired in 2015.

Skills and experience

John has extensive commercial and legal experience. He contributed considerably to the long-term strategy at Eversheds and helped drive considerable change, as it grew from a group of affiliated UK offices into a major international law firm.

Other roles

Member of the Law Society Business and Oversight Board, member of the Audit and Constitutional Committees of the International Bar Association and a member of the board of TheCityUK.

Committee membership

Chairman of the Board Governance and Nominations Committee and a member of the Remuneration Committee.

Neeta Atkar BSc
Independent Non Executive Director

Joined the Board in 2017.

Background and career

Neeta began her career at the Bank of England, including roles in the Bank's own banking department and its supervisory function. She moved to the Financial Services Authority (FSA) on its creation, leaving in 2000 to move into consulting, working with a range of financial services clients. Following this Neeta held senior positions in the financial services sector, including Chief Risk Officer at TSB where she was a member of the executive team that created and listed the bank on the Stock Exchange.

Skills and experience

Neeta has 30 years' experience working in financial services, both in the private and public sectors across a range of risk disciplines, including credit, operational, financial crime and regulatory risks.

Other roles

Non Executive Director of the British Business Bank plc and Chair of their Risk Committee.

Trustee of the National Skills Academy for Financial Services. Neeta has also been a magistrate for 20 years.

Committee membership

Chair of the Group Risk Committee and a member of the Audit Committee.

Alison Hutchinson BSc, CBE
Independent Non Executive Director

Joined the Board in 2015.

Background and career

Starting her career at IBM, Alison progressed to become Global Director of Online Financial Services. In 2000, she joined Barclays Bank and held senior management positions including Marketing Director of Barclaycard. In 2004 Alison moved to specialist mortgage provider Kensington Group, as Managing Director and then Group CEO, leading the successful sale of the business to Investec in 2008.

After leaving Investec in 2008, Alison launched The Pennies Foundation, a registered charity which supports digital donations to good causes. She has been the Chief Executive Officer of the Foundation since 2009.

Skills and experience

With a strong background in IT and financial services, Alison has extensive experience in the retail financial services sector. She has more than 20 years of management and board level experience.

In 2016, Alison was awarded a CBE for services to the economy and charities.

Other roles

Chief Executive of The Pennies Foundation and a Non Executive Director of Liverpool Victoria Friendly Society Ltd.

Committee membership

Member of the Group Risk Committee, Remuneration Committee and Board Governance and Nominations Committee.

Gordon Ireland BSc, FCA

Independent Non Executive Director

Joined the Board in 2015.

Background and career

Gordon is a chartered accountant and worked for 36 years at PwC, including 24 years as a partner, where he specialised in the financial services sector. His role included Vice Chairman of PwC's UK supervisory board and Chairman of the partner admissions panel and senior management remuneration committee. Following this, he was CEO of a professional indemnity captive insurer of PwC's network.

Skills and experience

Gordon's role at PwC included auditing many of the UK's leading insurance companies, and acting as an audit review partner. He also represented PwC on external technical advisory groups at a UK and European level.

Other roles

Non Executive Director of Aspen Insurance Holdings Ltd where he is Chair of the Audit Committee and a member of the Risk Committee. Gordon is also a Non Executive Director of Aspen Insurance UK Ltd and Iccaria Insurance ICC Ltd.

Committee membership

Member of the Group Risk Committee and Audit Committee.

Mark Pain BSc, FCA

Independent Non Executive Director and Vice Chairman

Joined the Board in 2013 and appointed as Vice Chairman and Senior Independent Director in 2015.

Background and career

Mark spent 16 years with Abbey National Group, including roles as Group Finance Director, CEO of Abbey National Treasury Services and Customer Sales Director. He was also Group Finance Director at Barratt Developments PLC. He has 10 years' experience in a number of non executive positions across several sectors, including LSL Property Services plc, Punch Taverns plc, Spirit Pub Group plc, Johnston Press plc and Aviva Insurance Ltd.

Skills and experience

With 20 years' experience of director level roles within FTSE100 companies, Mark brings a wide range of skills and experience in risk management and governance, strategic planning, treasury services, business leadership and change. Mark has a strong technical finance background and in depth knowledge of retail financial services.

Other roles

Chair of London Square Ltd and LSQ Management Ltd and a Non Executive Director of Ladbrokes Coral Group plc.

Committee membership

Chairman of the Audit Committee and a member of the Group Risk Committee and Board Governance and Nominations Committee.

Guy Parsons BA

Independent Non Executive Director

Joined the Board in 2013.

Background and career

Guy was a director of Accor UK, responsible for sales, marketing and operations for the Novotel hotel chain. He has also held director positions at Whitbread PLC as Sales and Marketing Director for the hotel division and as Managing Director for TGI Fridays. In 2004 he joined Travelodge, becoming CEO in 2010 and successfully growing the business to over 500 hotels in the UK, Ireland and Spain. In August 2015, Guy was appointed as easyHotel plc CEO.

Skills and experience

Guy has more than 25 years' experience of director level roles in the leisure and hospitality industry.

Other roles

Chief Executive of easyHotel plc and easyHotel UK Ltd.

Committee membership

Chairman of the Remuneration Committee.

Executive Directors

Mike Regnier MEng, MBA
Chief Executive Officer

Joined the Society and Board in 2014, and was appointed Chief Executive Officer in January 2017.

Background and career

Prior to joining the Society, Mike held a number of senior positions at Lloyds Banking Group, including Personal Current Accounts and Credit Cards Director. Most recently, he was the Products and Marketing Director for TSB. He has also held management positions at Asda and the Boston Consulting Group.

Mike joined the Society as Chief Commercial Officer and Executive Director and became Chief Customer Officer in December 2015, responsible for the Group's Branch Network, Product Development, Marketing, Customer Experience and Customer Relations functions.

Skills and experience

Mike has 10 years' experience in strategic management consulting and over 10 years' experience in financial services.

Alasdair Lenman MA, ACMA
Chief Finance Officer

Joined the Society and the Board in 2017.

Background and career

Alasdair began his career on the management training programme at Mars Inc. where he spent a number of years working in sales, before making the decision to move into finance. Since then he's gained significant experience in the financial services sector, including as Finance Director of Retail Products for Lloyds Banking Group, and as Group CFO for BGL Group.

Skills and experience

Alasdair has a strong finance background with over 20 years' experience, including running the finance function for a large mortgages and savings business and having previously acted as a Group CFO. Alasdair has served as a Non Executive Director and Audit Committee Chairman for both Sainsbury's Bank and the Coventry Building Society.

Stephen White BComm
Chief Operating Officer

Joined the Society and the Board in 2016.

Background and career

Started his career as a retail branch manager for Abbey National, Stephen subsequently gained further experience in management roles at Ernst & Young and Abbey National. He was also an Executive General Manager at National Australia Bank looking after Payments and Customer Operations and prior to YBS he was Group Chief Operating Officer at Allied Irish Bank.

Passionate about the mutual sector and customer service, Stephen is responsible for the Group's Operations and Customer Service functions, including Customer Relations, Lending, Customer Services, Arrears and Collections, Property and procurement, the Group's IT, Information Security, Financial Crime, Fraud, Transformation, Innovation and Change Management. Stephen is also Chairman of Accord Mortgages Limited.

Skills and experience

Stephen has over 25 years' experience in financial services and has worked at a senior level globally, including significant time in Australia, Asia, Ireland and in the UK.

Other Chief Officers

Charles Canning
Chief Customer Officer

Joined the Society in 1987.

Background and career

Charles was promoted to the leadership team in 2005 and has held a variety of roles including Head of Branch Network and Head of Distribution responsible for the branch and agency network and telephony sales. More recently he was promoted to Chief Customer Officer and has overall responsibility for all aspects of distribution and the delivery of an exceptional customer experience.

Skills and experience

Charles has over 30 years' experience with the Society across many areas and is also a director of Accord Mortgages Limited, the Society's wholly owned intermediary lending subsidiary.

Richard Wells FCIB
Chief Risk Officer

Joined the Society in 2010.

Background and career

Richard has held a number of senior risk management roles at several of the UK's major banks and building societies. Richard is responsible for ensuring that appropriate procedures and capability exists within the Group for the management of all the risks that it has planned to take, or that it encounters. He is also responsible for the Legal and Group Secretariat functions.

Skills and experience

Richard has extensive experience of risk management within the financial services industry. He is also a director of Accord Mortgages Limited.

The running of the Society is the responsibility of your Board of directors. Each year we ask our members to vote on the election of new directors appointed by the Board or re-election of existing directors at our AGM.

Other Chief Officers

Greg Willmott MA, BPhil
Chief Strategy & Digital Officer

Susana Berlevy
BSc, MA, CIPD
Chief People Officer

Joined the Society in 2018.

Background and career

With extensive experience in retail financial services, Greg's corporate roles include Development Director for Zurich UK, Strategy and Development Director for Aviva in the UK and Principal in Barclays' in-house strategy team. He also has extensive experience in strategy consulting with PA, KPMG, Towers Watson and as a freelance adviser.

Greg and his team are responsible for developing and embedding the Group and digital strategies, strategic and customer-centred insight and proposition development, building our external brand, reputation and influence and driving the Society Matters agenda on behalf of the Group.

Skills and experience

Greg has 20 years' experience in corporate strategy and development, from major corporations to private equity to start ups, with significant recent work in digital, innovation and disruption.

Joined the Society in 2018.

Background and career

Susana began her career working in her native Spain for the national oil company, CAMPSA, before moving to the UK and progressing her HR career with Iberia Airlines, the British Standards Institution, Hiscox, RBS, HSBC, BP, International Power, and then Lloyds Banking Group.

She held a number of senior HR roles at Lloyds including HR Director for the Risk & Legal Division overseeing the introduction of the Senior Managers Regime across the Bank, and then as HR Director to the Digital Bank. Most recently Susana was the Group HR Director for Ed Broking, a Lloyds of London insurance broker.

Skills and experience

A psychologist by training, Susana has over 20 years' HR experience in financial services and other sectors.

Directors' Report

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

Business objectives, future developments and key performance indicators

Information on the Group's vision and strategy, and future outlook is set out in the Strategic Report on pages 12 to 37 together with its principal key performance indicators.

Profit and capital

The profit and capital position of the Group is set out in the Strategic Report on pages 12 to 37.

Mortgage arrears

Details of the Group's mortgage accounts which were 12 months or more in arrears at 31 December 2017 were as follows:

	2017	2016	**2017**	2016
			% of mortgage accounts/balances	
Number of accounts	**155**	207	**0.06**	0.08
Balances outstanding on accounts	**£21.3m**	£30.1m	**0.06**	0.09
Amount of arrears included in balances	**£2.5m**	£4.2m	**0.01**	0.01

Further details of the Group's arrears position are set out in the Strategic Report on page 34. Note 39 on page 164 describes the various forbearance measures offered by the Group to borrowers experiencing difficulties in meeting their repayments.

Disclosure requirements under CRD IV country-by-country reporting

The following information has been disclosed in this report in compliance with the Regulations of Article 89 of the Capital Requirements Directive IV (CRD IV) country-by-country reporting (CBCR). Yorkshire Building Society is the parent company and a list of the subsidiaries can be found in Note 10 of these accounts. The principal activities of the Group can be found in the Strategic Report on page 15 and in Note 12. All Group companies operate in the United Kingdom except Yorkshire Guernsey Ltd which is registered in Guernsey and is in the process of liquidation. Therefore, total income and profit before tax shown in the Income Statement and corporation tax paid shown in the Statement of Cash Flows, as well as the average number of employees disclosed in Note 7, are related to the United Kingdom. No public subsidies were received in 2017.

Risk management

As a result of its normal business activities, the Group is exposed to a variety of risks, including credit, market, liquidity and funding, conduct, operational and business risk. These are discussed in the Strategic Report on pages 35 and 36. The Group seeks to manage all the risks that arise from its activities and has established a number of committees and policies to do so. Details of these are set out in the Risk Management Report on pages 61 to 69 and Corporate Governance Report on pages 45 to 55.

Charitable and political donations

In 2017 the Group made charitable donations of £1,199,285 (2016: £1,683,820) which included donations of £293,352 to End Youth Homelessness (2016: £320,148 to Marie Curie). In addition, employees have contributed time for volunteering to the community of £378,151 (2016: £388,520) and YBS Group donated £30,000 (2016: £30,000) to the Yorkshire Building Society Charitable Foundation. No political donations were made during the year.

Directors' Report continued...

Colleagues

In 2018 we will continue to listen and respond to our colleagues' needs during a period of impactful change, with a particular focus on practical tools and support for colleague wellbeing and resilience through change. There is a comprehensive internal communications structure to cascade relevant business information to employees throughout the organisation in an appropriate and timely way. We are committed to building a diverse workforce that genuinely represents the best interests of our colleagues and customers and fostering an inclusive environment where everyone connected to the Group can contribute to its success. We recognise that people from different backgrounds and experiences enhance the way we work and reasonable adjustments for colleagues with a disability are taken into account.

Further details on colleague engagement can be found in the people experience section of the Strategic Report on pages 22 to 25.

Directors

The names of the directors of the Society who served during the year, their roles and membership of Board committees are described in the Corporate Governance Report on pages 45 to 55.

At the 2018 Annual General Meeting (AGM) Neeta Atkar and Alasdair Lenman will stand for election and the other directors will retire and stand for re-election. Biographical details of all directors are outlined on pages 38 to 40.

None of the directors had an interest in, or share of, any associated body of the Society at any time during the financial year.

The directors in office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditor is unaware.

Directors' responsibilities in respect of preparation of the Annual Report and Accounts

The following statement, which should be read in conjunction with the statement of the Auditor's responsibilities on page 92, is made by the directors to explain their responsibilities in relation to the preparation of the Annual Accounts, Annual Business Statement and Directors' Report.

The directors are required by the Building Societies Act 1986 (the Act) to prepare, for each financial year, Annual Accounts which give a true and fair view of the income and expenditure of the Society and the Group for the financial year and of the state of the affairs of the Society and the Group as at the end of the financial year and which 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 those Annual Accounts, the directors are required to:

- Select suitable accounting policies and apply them consistently.
- Make judgements and accounting estimates that are reasonable and prudent.
- State whether the Annual Accounts have been prepared in accordance with IFRS.
- Prepare the Annual Accounts on a going concern basis, unless it is inappropriate to presume that the Group will continue in business.

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

The directors are responsible for the maintenance and integrity of statutory and audited information on the Society's website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' responsibilities in respect of 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 Act.
- Take reasonable care to establish, maintain, document and review such systems and controls as are appropriate to its business in accordance with the rules made by the PRA under the Financial Services Act 2012.

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

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

Going concern

The directors have confirmed that it is appropriate to adopt the going concern basis in the preparation of the financial statements in the Strategic Report on page 37.

Auditor

The reappointment of Deloitte LLP as auditor is to be proposed at the AGM.

On behalf of the Board

John Heaps
Chairman
28 February 2018

Chairman's statement

Dear Member

I am responsible for ensuring that the Society maintains the highest standards of corporate governance with a clear framework for the way in which the Board (and the rest of the Group) operates. Good corporate governance is vital in providing effective leadership and in assisting the Society to continue as a successful sustainable organisation which is run for the benefit of its current and future members and all our stakeholders in a legal, ethical and transparent manner.

In keeping with the long-established tradition of the building society movement, we operate to help our borrowing and saving members and seek to optimise rather than to maximise profits. During the year the Board has overseen a move towards simplifying how the business operates and this has resulted in a number of brand, product and distribution changes. Further details on these initiatives are set out in the Chief Executive's introduction and the Strategic Report on pages 12 to 37. Our mutual status means that we are not driven by the requirements of shareholders and do not have to balance satisfying their needs with providing good customer service in the way some established 'plc' banks are required to do. Our members are both our customers and the owners of the Society and they are a key influence on the Board's approach to corporate governance, with the interests of members at the heart of the Board's decision making processes.

The Board's approach to corporate governance is also influenced by the following considerations:

- The accountability of the Board to the Society's members for the conduct and performance of the business.
- The interests of other stakeholders, including all our customers, colleagues, suppliers and the wider community are also taken into account.
- The management of the Group in a prudent and efficient manner with effective decision making and robust risk management.
- The effectiveness of the Board for the financial strength and future success of the Group.

This approach is based on the principles and provisions of the UK Corporate Governance Code (the Code) published by the Financial Reporting Council (FRC) to the extent that they are relevant to a building society. A revised Code was published in June 2016 and took effect for the 2017 reporting year. However, the Society voluntarily chose to adopt the new version of the Code early in the 2016 reporting year. A copy of the Code is available at www.frc.org.uk. In the interest of transparency, our regulators, the FCA and the PRA, also encourage each building society to explain in its Annual Report and Accounts whether, and to what extent, it adheres to the Code. We will be keeping up to date with changes to the Code following the publication of the FRC's consultation document in December 2017. It is expected that a new Code will be published in summer 2018 and we will be working to ensure that we continue to 'comply or explain' with any new provisions as well as those retained from previous versions of the Code.

The significant volume of legislation, regulation and guidance in the governance world continues to make board governance an important element of my role in ensuring that the Board is fit for purpose and capable of responding to the fast moving and challenging market place in which we operate. It is important that all Board members ensure that they remain up to date with governance developments and we are supported in this by the Board Governance and Nominations Committee which continues its role in monitoring developments and making recommendations for changes to the Board. In particular, I am responsible for ensuring that the Board has the right mix of skills, diversity and independence and is effective in all aspects of its role. The Board Governance and Nominations Committee keeps the composition of the Board and future succession planning under regular review to ensure that the Board retains the skills it needs to be effective.

In January 2017 the Board appointed a new Chief Executive, Mike Regnier, who was previously the Chief Customer Officer and Executive Director. In April the Board welcomed a new Non Executive Director, Neeta Atkar. Also in April, David Paige and Dame Kate Barker retired from the Board. In December Alasdair Lenman replaced Robin Churchouse as Chief Finance Officer and Executive Director. Robin Churchouse stepped down from the Board in September 2017 at which time Rob Purdy, his deputy, stood in during the interim period.

Throughout the recruitment process it has been important to ensure a continuity of skills was maintained whilst adding further strength in key areas such as risk. Further details are provided in the following Corporate Governance Report and the report of the Board Governance and Nominations Committee.

The Board is responsible for agreeing and leading the development of the Group's culture; how things get done and how our colleagues behave is just as important as what gets done. The Society continues to have a strong culture; its values are well understood, our colleagues are warm, friendly and passionate about what they do. In 2016 we appointed an external partner, t-three, to work with us on understanding and developing our culture in line with our strategy and vision, and to reinforce the behaviour that we expect of all our colleagues.

Corporate Governance Report continued...

Cultural development activity at the Group is focused upon building on existing cultural strengths and moving towards a culture that emphasises:

- Commercial focus and pace.
- Trust and empowerment.
- Working together.
- Open and honest conversations.

The Board has continued to be fully engaged in this work throughout 2017, monitoring the evolution and development of our culture against agreed plans. This included a session in March, focusing on how the Board can experience and gauge the culture for themselves. Following this session, management information in relation to culture was shared in July and December which drew from colleague engagement survey data and behavioural observations from our oversight functions in order to describe the progress of alignment with the target culture.

As reported last year in the Corporate Governance Report, a substantial amount of work has been undertaken to ensure the Society was prepared for the implementation of the regulator's Senior Managers and Certification Regime (SMCR) in March 2016 and this has continued to ensure 'Our Trust Code', as it is known in the Group, is and remains embedded. Whilst the Conduct Rules under the SMCR were extended to cover all Non Executive Directors in 2017, Our Trust Code All Colleague Rules (the SMCR Individual Conduct Rules) have already applied to all our Non Executive Directors since March 2016. All of our colleagues, including Executive and Non Executive Directors, complete an annual online learning module to ensure a consistent Group-wide understanding of the regulations, including the Conduct Rules.

The opportunity was also taken, under the leadership of Mike Regnier, to review and subsequently rationalise the senior management structure which has resulted in a more streamlined and focused team which now comprises an Executive Committee and an Operating Committee. The Executive Committee is responsible for overseeing and directing the management of all aspects of the Group with the specific aim of delivering the Group's purpose, vision, values, strategies and operating plan. The Operating Committee is responsible for Group-level operational decisions with a specific focus upon trading, service, people and cost.

I am pleased to report that throughout 2017 the Society complied with the Building Societies Association guidance on the Code. This Report sets out below how the Board has operated in 2017 and applied the main Principles of the Code.

John Heaps
Chairman
28 February 2018

Leadership

The role of the Board

The Society is headed by the Board which is accountable to the members of the Society. It operates under formal Terms of Reference (with a schedule of matters reserved to the Board) which include:

- Being collectively responsible for the success, including the long-term success, of the Group and for acting in the best interests of the Society and its members as a whole (both current and future) and having regard to the interests of other customers, colleagues, suppliers and the wider community.
- Having responsibility for the overall management of the Group within a framework of risk management which supports and directs financial security, fair outcomes and a Group built on trust.
- Establishing a sustainable business model and setting the strategy of the Group consistent with that model.
- Developing the culture of the Group (including a culture of risk awareness, prudent management and openness with the regulators) and setting a 'tone from the top' to ensure that the desired values and behaviours are Board led.
    - Oversight of the Group's operations ensuring competent and prudent management is in place.
    - Sound planning and risk management.
    - Adequate systems of internal control.
    - Adequate accounting and other records.
    - Compliance with statutory and regulatory obligations.
    - Adequate financial resources.
    - Fair treatment of all customers.
    - Appropriate risk aligned remuneration systems.
- Reviewing the performance of the Group in the light of the strategy and Corporate Plan and ensuring that any necessary corrective action is taken. An essential part of this is the review of the Board Management Information.

Matters reserved to the Board

As referred to above, the Board maintains a schedule of matters that are reserved for the Board's decision, which is reviewed at least annually, in order to ensure that it exercises control over the business of the Group. These include the approval of:

- Annual Report and Accounts and the Interim Financial Statements.
- Strategic aims of the Group, including mergers and other acquisitions and disposals.
- Corporate Plan.
- Core strategies (i.e. Customer, Corporate Responsibility, Financial, IT, People and Operational strategies).
- Certain policies including the Anti-bribery and Corruption, Commercial and Retail Lending, Ethical and Vulnerable Customers policies.
- Group's Risk Appetite.
- Other matters which must be approved by the Board under legislation and the Society's Rules.
- The appointment of Executive and Non Executive Directors and Chief Officers.

The Board delegates the implementation of the strategy and the day-to-day management of the Group to the Leadership Team which is led by the Chief Executive Officer. It delegates certain other responsibilities to Board Committees as set out in the Committees' Terms of Reference.

A copy of the Board's Terms of Reference and Matters Reserved to the Board are available on request from the Group Secretary or can be found on the Society's website at ybs.co.uk/board

Board Committees

As referred to above, certain matters are referred to Board Committees in order that they can be considered in more detail by those directors with the most relevant skills and expertise. Details of the Board Committees are:

- Audit Committee – details including membership and responsibilities are contained in the Audit Committee Report on pages 58 to 60.
- Board Governance and Nominations Committee – details including membership and responsibilities are contained in the Board Governance and Nominations Committee Report on pages 56 to 57.
- Group Risk Committee – details including membership and responsibilities are contained in the Risk Management Report on pages 61 to 69.
- Remuneration Committee – details including membership and responsibilities are contained in the Directors' Remuneration Report on page 84.
- Chairman's Committee – the members of the Committee are:
    - The Chairman of the Board, (John Heaps);
    - The Vice Chairman, (Mark Pain); and
    - The Chief Executive, (Mike Regnier).

  Other directors may be co-opted onto the Committee, as agreed by the Board, to consider specific matters. The Committee's main function is to consider any matter which the Board has specifically delegated to it.

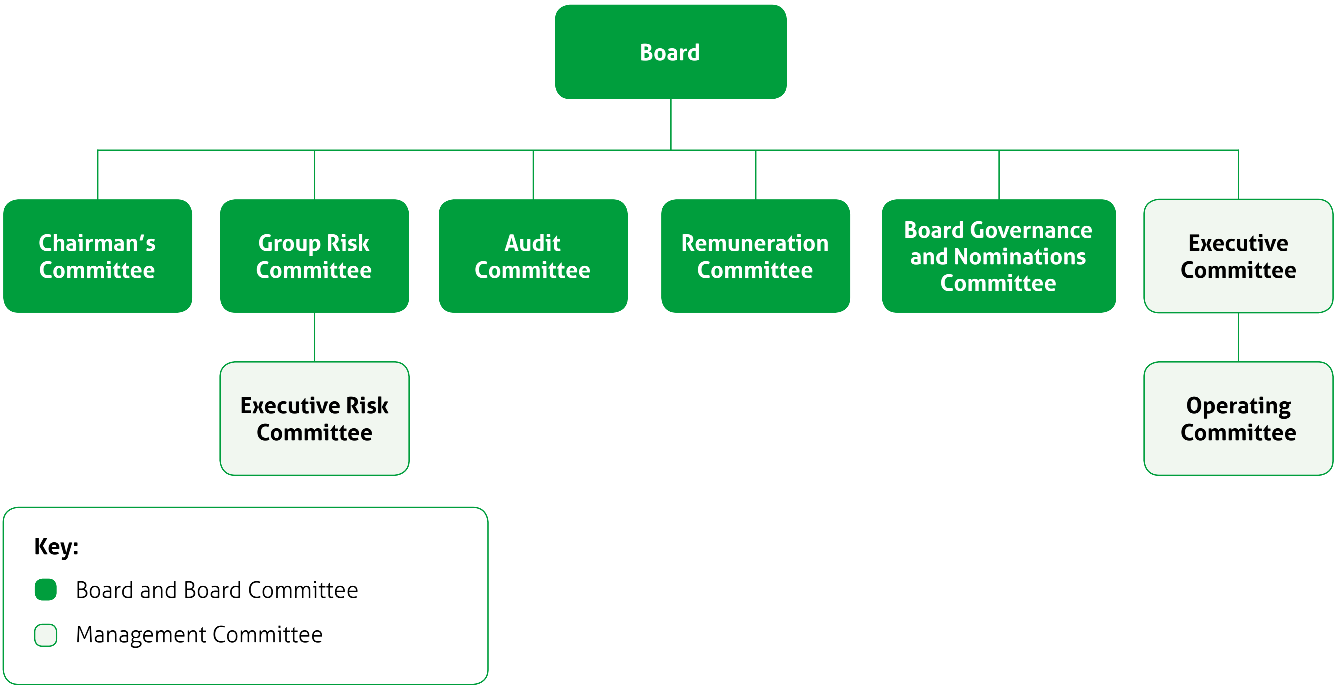
The Terms of Reference of the Audit, Group Risk, Remuneration and Board Governance and Nominations Committees are available on request from the Group Secretary or on the Society's website at ybs.co.uk/committees

The Chair of each Committee reports to the subsequent Board meeting on the matters discussed at each Committee meeting. The minutes of each Committee meeting are circulated to all directors unless it is considered inappropriate to do so.

Corporate Governance Report continued...

Board and Committee structure

The Board, Board Committee and Management Committee structure is set out below:



In addition, there is a suite of sub committees that report into the Executive Risk Committee.

The management committee structure was revised during the year to streamline the way in which the Group operates and to further embed SMCR by the replacement of the Executive Management Committee with the Executive Committee (ExCo). The role of ExCo is to oversee and direct the management of all aspects of the Group with the specific aim of delivering the Group's purpose, vision, values, strategies and operating plan. Its membership is made up of all the Chief Officers, including Executive Directors.

An Operating Committee was also established to replace a number of management committees. It is a sub committee of ExCo which has delegated authority to it to take Group level operational decisions with a specific focus upon trading, service, people, cost and risk.

Board meetings

The Board held nine scheduled meetings in 2017 together with one additional meeting convened at short notice to consider an ad hoc matter. The attendance record of each director at the scheduled Board meetings and at relevant Board Committee meetings is set out on page 49. Where a director is unable to attend a meeting they will provide comments on the agenda items to the Chairman prior to the meeting.

To provide focus on the development of strategy, twice a year (usually in June and September/October) the Board has specific strategy sessions outside of the usual Board meetings.

The Board generally meets in West Yorkshire, either Leeds or Bradford, but at least one meeting each year is held in a location outside West Yorkshire where the Group has an administrative centre. In October 2017 the meeting was held at the administrative office in Peterborough where the directors, in particular the Non Executive Directors, had an opportunity to meet colleagues and answer any questions they had in question and answer sessions held prior to the Board meeting.

Board and Board Committee attendance record 2017

The table below sets out the details of the directors during 2017 and their attendance record at scheduled Board meetings and relevant Board Committee meetings in the year. The figure in brackets indicates the number of meetings that the director was eligible to attend as a member of the Board and relevant Committee(s) during 2017. The Chairman and Chief Executive usually attend all Board Committee meetings at the invitation of the Committee Chair.

Director	Board	Board Committees				
		Chairman's	Audit	Board Governance and Nominations	Remuneration	Group Risk
John Heaps						
Chairman	10(10)	2(2)	–	4(4)	4(4)	–
Neeta Atkar						
Non Executive Director (Appointed 25.04.2017)	6(7)	–	3(3)	–	–	2(2)
Dame Kate Barker						
Non Executive Director (Retired 25.04.2017)	4(4)	–	–	1(1)	2(3)	1(2)
Robin Churchouse						
Chief Finance Officer and Executive Director (Resigned 30.09.2017)	8(8)	–	–	–	–	–
Alison Hutchinson						
Non Executive Director	10(10)	–	2(2)	3(3)	7(7)	2(2)
Gordon Ireland						
Non Executive Director	10(10)	–	3(3)	–	–	4(4)
Alasdair Lenman						
Chief Finance Officer and Executive Director (Appointed 04.12.2017)	1(1)	–	–	–	–	–
David Paige						
Non Executive Director (Retired 25.04.2017)	4(4)	–	2(2)	–	–	2(2)
Mark Pain						
Vice Chairman / Senior Independent Director	10(10)	2(2)	5(5)	4(4)	–	4(4)
Guy Parsons						
Non Executive Director	9(10)	–	–	–	7(7)	–
Mike Regnier						
Chief Executive Officer and Executive Director	10(10)	2(2)	–	–	–	–
Stephen White						
Chief Operating Officer and Executive Director	10(10)	–	–	–	–	–

Notes:

- There were nine scheduled Board meetings and one additional meeting which was convened at short notice to consider an ad hoc matter.
- A sub committee of the Board was held in July 2017 for final ratification of the Interim Financial Statements subsequent to approval by the Board. The members of the Committee were Mike Regnier, Mark Pain and Robin Churchouse.
- The Written Resolution procedure under the Society's Rules was used on three occasions by the Board, on six occasions by the Remuneration Committee and on one occasion by the Group Risk Committee to conduct business.

Corporate Governance Report continued...

Board agenda items

The key matters considered by the Board are planned on a rolling 12 month basis with additional ad hoc items included throughout the year as appropriate. At each Board meeting, the Board receives a comprehensive management information pack covering business performance including financial and non-financial information and scorecards to monitor progress against key performance indicators (including customer and people metrics) and the business risk appetite.

The Board pack also incorporates a report on the external and competitive environment, which includes ongoing monitoring of a range of potential economic indicators arising from the decision to leave the EU as a result of the referendum held in June 2016.

Where appropriate, the relevant Executive Director or Chief Officer provides an oral update to the Board on the particular aspects of performance and highlights any emerging issues. In addition, the Board agenda includes the following:

- Minutes of Board Committee meetings held since the previous Board meeting and oral updates from the Chairs of Board Committees on the main issues discussed and matters agreed. This ensures that all Board members are aware of the key discussions and decisions made by the Committees.
- Minutes of the meetings of the monthly ExCo and bi-annual reports from the Chairman of the Board of Accord Mortgages Limited, our intermediary lending subsidiary.
- A report from the Chief Executive which highlights the current trading and financial performance and any other relevant matters he wishes to bring to the attention of the Board.
- A quarterly report on risk including performance against the agreed risk appetite and details of compliance/monitoring reports undertaken.
- A quarterly report on the progress of the key strategic priorities.
- Items for decision and key matters which need to be debated. For example, in 2017 the matters that the Board considered included the following:
  - Approval of the 2016 Annual Report and Accounts and the 2017 Interim Financial Statements.
  - The implementation of the distribution strategy including changes in relation to the Group's brands and branch/agency network.
  - Interest rates and the response to the Bank of England Bank rate change.
  - The management of conduct and prudential risk including regulatory dialogue and correspondence.
  - Results of the annual Best Workplaces survey.
  - Approval of the first annual review of the Society's Corporate Responsibility Report, Society Matters.
  - Updates in relation to the management of cyber security.
  - General Data Protection Regulation (GDPR).
  - Cost efficiency initiatives.
  - Senior executive succession planning.
  - Director and senior executive appointments.
  - Review of the leadership and business governance structures.
  - Updates on the approach to culture and diversity.
  - Consideration of the Group's basis risk position and its management.
  - Internal Ratings Based (IRB) application process.
  - The setting of, and the adherence monitoring of, the Group's Risk Appetite.
  - Approval of the Modern Slavery Act Statement.

If a major item requires further detailed consideration then the Board may delegate this to an appropriate Board Committee.

As referred to above, the Board holds two separate strategy sessions each year. In 2017 these sessions included detailed reviews of a number of matters including the customer, distribution, commercial, and product strategies and the change portfolio.

Non Executive Directors

In addition to playing their part on the Board as a whole, the Non Executive Directors are responsible for bringing independent judgement to Board debate and decisions using their own experience and skills, and for constructively challenging the leadership team.

The Non Executive Directors meet without the Executive Directors present to discuss relevant matters; in 2017 discussions included Board agenda topics, succession planning and the overall performance of the leadership team.

The Vice Chairman, who is also the Society's Senior Independent Director, deputises for the Chairman when appropriate and provides support and guidance to him. He would also act, if required, as an intermediary for the other directors. As Senior Independent Director, the Vice Chairman is also the main point of contact for members should the normal channels of communication with the Chairman, Chief Executive or other Executive Directors fail or be inappropriate.

The roles of the Chairman and the Chief Executive

The roles of the Chairman and Chief Executive are held by different people and are distinct in their purpose. The roles are set out in writing in the respective role profiles and can be summarised as follows:

The Chairman is responsible for leadership of the Board and for ensuring that the Board acts effectively, promoting high standards of corporate governance. He is also responsible for leading the development of the Group's culture by the Board and thus setting the 'tone from the top'.

The Chief Executive has overall responsibility for managing the Society and its subsidiaries and for implementing the strategies and policies agreed by the Board, supported by the Executive Team and through a suite of management and risk committees.

In addition, the Prescribed Responsibilities under the Senior Managers Regime have been allocated where relevant to the Chief Executive and Chairman (as well as to other senior managers).

Effectiveness

Independence

The Board is satisfied that all of the Non Executive Directors are independent based upon the guidance set out in the Code, including the Chairman on appointment.

Composition of the Board and succession planning

As at 31 December 2017, the Board is comprised of nine (2016: 10) directors consisting of the Chairman, three (2016: three) Executive Directors and five (2016: six) Non Executive Directors. The size and composition of the Board and the Board Committees are kept under constant review by the Chairman and the Board Governance and Nominations Committee (BGNC). This is to ensure that there is adequate and orderly succession planning for Executive and Non Executive Directors and that there is the optimum mix of skills and experience on the Board for the direction of the Group's activities and to populate and chair the Board Committees. The Board accepts that there needs to be flexibility in the number of directors (particularly in the number of Non Executive Directors), to take into account any future skills or experience gaps, either due to changes in the Group's business activities or as part of ongoing succession planning and recruitment.

Non Executive Director succession planning

The BGNC reviews a skills matrix of the Non Executive Directors each year; this consists of a schedule of desired skills within the non executive population and a self-evaluation of the level of experience against each skill gained outside of the Group and taking into account the Group's strategic plans. The Committee also reviews at each meeting the anticipated retirement date and continued independence of each Non Executive Director and the impact on Board Committee membership. These processes assist in the forward recruitment planning including the skills and experience required of the successful candidate.

Further details are contained within the report of the Board Governance and Nominations Committee set out on pages 56 to 57.

Executive Director and senior management succession planning

The Group has an integrated Talent Management Strategy which aims to create a consistent and robust approach to succession planning across the Group, including the Executive Director roles. The members of the Executive Team are fully engaged in succession planning for their roles, their direct report roles and for considering key person risk. Talent reviews are conducted twice yearly based upon a review of existing data, identification of development needs, Talent Forums and individual data.

An update is provided to the BGNC in June each year and an annual review is undertaken by the Non Executive Directors of the succession plan status for roles within the Executive Team (i.e. the Executive Directors and other Chief Officers) in January each year.

The structure of the Leadership Team was reviewed in 2017 resulting in the implementation of a new and more efficient management structure from September 2017. The simplified senior management structure provides greater clarity and accountability to enable the Group to be more responsive to developments in financial services and the needs of our customers.

Details of the Society's Directors and Chief Officers are set out on pages 38 to 42.

Changes to the Board

During 2017 there were a number of Board changes:

- Mike Regnier became Chief Executive on 1 January 2017 (the former Chief Executive, Chris Pilling, having stepped down from the Board on 31 December 2016). Mike joined the Society in June 2014 as Chief Commercial Officer and Executive Director, and became Chief Customer Officer in December 2015 until his appointment as Chief Executive.
- David Paige, Non Executive Director and Chair of Group Risk Committee, and Dame Kate Barker, Non Executive Director, both retired from the Board at the AGM on 25 April 2017.
- Neeta Atkar joined the Board on 25 April 2017 as a Non Executive Director and Chair of the Group Risk Committee.
- Robin Churchouse, Chief Finance Officer, stepped down from the Board on 30 September 2017. He was succeeded by Alasdair Lenman who joined the Society and the Board on 4 December 2017. During the interim period Rob Purdy, Robin Churchouse's deputy, assumed his responsibilities.

The appointments of Neeta Atkar and Alasdair Lenman are subject to election by members at the AGM to be held on 25 April 2018.

Further details on the recruitment of directors can be found in the Board Governance and Nominations Committee Report on pages 56 and 57.

Diversity

The Board gives consideration to all aspects of diversity when reviewing the composition of the Board and in identifying suitable candidates for the position of director. The annual review of the statement on Board diversity was completed in conjunction with the Group's Diversity and Inclusion Manager and a revised Board Diversity Statement was approved in December 2017 to take into account the Board's wider commitment to diversity and following benchmarking against similar organisations.

Corporate Governance Report continued...

The Group's diversity and inclusion ambition is to foster an inclusive environment where everyone can contribute to the Group's success. The Board believes investing in this culture is fundamental in ensuring it attains its aspirations as a Society. We recognise the importance of having a diverse Board (and workforce generally) not least because it reflects the make-up of the membership and the community at large but it also makes commercial sense, being the governing body of the Society. The Board places great emphasis on ensuring that its composition will reflect a comprehensive range of differing skills, experience and perspectives, whilst supporting good governance through different insights, challenge and dynamics. Nevertheless, it continues to adopt the principle that all appointments should be based on merit and the skills and experience the individual can bring to the Board as a whole.

The Board Diversity Statement also notes the commitment to investing in the senior talent pipeline, particularly nurturing black, Asian and minority ethnic (BAME) and female talent and delivering tailored leadership development and robust succession planning. This was underpinned by the Board's commitment to developing an inclusive culture while undertaking appropriate training to support the delivery of this policy.

The Board Governance and Nominations Committee will continue to review the position in relation to the Board Diversity Statement and report annually on the agreed objectives and the progress against those objectives, together with other initiatives to promote diversity.

Work is ongoing with the National Centre for Diversity to work towards the Investors in Diversity Accreditation. As part of the work towards achieving the standard, in July 2017 a comprehensive survey of the business was completed to gather data and insights which will drive specific actions and activities. We are currently progressing with activity that will help us to work towards the attainment of the accreditation in the third quarter of 2018 and we have recently received conditional accreditation. The following were some of the Group's key achievements in 2017:

- Developed and communicated our Diversity and Inclusion ambition.
- 'Celebrate Difference' workshops (a basic introduction to Diversity and Inclusion) delivered across the Group reaching over 1,000 colleagues.
- Mobilised 66 Agents of Change, 'diversity champions' located across the business.
- Strong working relationship developed with Aegis, the Society's Union, who are fully supportive of the Society's Diversity and Inclusion ambitions.
- Promoted the Group as a local inclusive employer at Bradford Festival and Leeds Pride weekend.
- Updated Diversity and Inclusion mandatory training launched for all colleagues.
- Diversity and Inclusion intranet page developed, including regular communication on inclusion topics and blogs.
- Joined Bradford Employers Network.
- Delivered Inclusive Leadership sessions to the Leadership Team.
- Became an active member of Creating Inclusive Cultures – a forum where like-minded businesses share best practice across a range of inclusion topics.

The Society also won the UK's Most Improved Organisation of the Year 2018 and the UK Financial Services Company of the year as awarded by the National Centre for Diversity.

The Board previously approved an aspirational target to have 25% women directors by the end of 2015. This aspirational target was reviewed by the Committee in November 2016 following which the Board approved a recommendation to increase the target to 30% women directors in the medium-term to bring it more into line with the latest Hampton-Alexander Review recommendation of 33% of women on the boards of FTSE 350 companies by 2020. The Committee also agreed that search and specialist recruitment agencies for director appointments should only be engaged if they have signed up to the Standard Voluntary Code of Conduct for Executive Search Agencies, with a preference to use those signed up to the Enhanced Code.

The percentage of women on the Society's Board at 31 December 2017 was 22% (2016: 20% excluding the outgoing Chief Executive). The revised aspirational target was therefore not met during 2017. The percentage is expected to continue to fluctuate during the ongoing recruitment process for a new Non Executive Director which is being conducted in line with the Board Diversity Statement.

By way of further information and in keeping with the Society's focus on diversity, as at 31 December 2017 there were the following percentages of women colleagues in the Group:

- 33% of the Executive Team (excluding Executive Directors). This reduced to 17% if Executive Directors are included.
- 30% of the next level of senior managers (i.e. the Leadership Team).
- 65% of all colleagues (including Executive Directors).

Board and committee evaluation

The Board undertakes a formal annual evaluation of its performance and that of its Committees, together with an annual review of the performance of individual directors. In accordance with the Code, which recommends the evaluation of the Board to be externally facilitated every three years, in the latter part of 2017 an external effectiveness review was carried out by SCT Consultants (SCT), which has no other connection with the Society.

The work carried out by SCT consisted of a review of key Board documents, a series of interviews with Board members and the Group Secretary, a confidential questionnaire to all Board members, along with attendance at the September 2017 Board meeting.

The outcomes of the review were presented to the January 2018 Board meeting and SCT confirmed that the Board operates in an effective and diligent manner, with directors acting openly and honestly. The review also observed that over the past year the level of collaboration between Board members has improved with a substantial amount of time and commitment having been given to the development of the Board. The range of issues identified in 2017 included Board purpose, culture, composition, meetings (including frequency and agendas) and member engagement. Good progress was made throughout the year in addressing these issues and the evaluation by SCT further supported their continuing development.

The SCT review identified some potential areas where there could be further improvement which would allow the Board to continue to be effective, exemplifying a positive culture and behavioural characteristics that reflect the values of the Society.

Key themes and actions agreed are outlined below:

Themes	Actions
Further strengthen the composition of the Board to bring additional expertise in areas such as retail banking and digitalisation.	Work is currently ongoing to recruit additional expertise to the Board taking into account the overall skills requirement of the Board. Future Board appointments will be communicated at the appropriate time.
Review the format of all Board and Committee papers to ensure that they allow directors to make informed decisions and that agendas are appropriately managed with the layout of meetings reflecting the roles of all Board members.	The Group Secretary has been tasked with reviewing Board and Committee papers with a view to streamlining and focusing the process to further improve decision making within the Group. This process, together with a wider review of business governance, has commenced with an implementation expected during Q2 2018.
Seek to identify additional ways of bringing the members' and customers' voice into the boardroom.	As a mutual organisation run for the benefit of our members, our customers are at the heart of our decision-making and it is important that we continue to seek areas of potential differentiation. This will be considered as part of the Group's review of its strategic priorities.
Ensure that the Board has a comprehensive succession plan.	Good progress has been made with the Board and senior management succession plan and this will be further developed during 2018 with reviews continuing to be carried out by the Board Governance and Nominations Committee.
Continue to identify the fundamental drivers of culture within the Society.	Organisational culture had been a strong focus of attention during 2017 and the existing and future target culture has been identified. Work has commenced on incorporating the target culture requirements into people practices and will continue to be progressed during 2018.
In relation to major investments it is recommended that the investment appraisal process should continue to be improved.	As part of a more general review of both Board and management information the Chief Finance Officer will carry out a review of the investment appraisal process.

Internal performance evaluations of the Audit, Group Risk, Remuneration and Board Governance and Nominations Committees were also carried out through the means of a questionnaire completed by all relevant Committee members and regular attendees and any appropriate improvements were identified for action by each of the Committees.

Corporate Governance Report continued...

Individual director evaluation

In early 2018 the evaluation of individual directors was undertaken through the completion of feedback questionnaires completed by the Non Executive Directors, Executive Directors and the Chief Officers.

The reviews concluded that all directors continued to perform effectively. The written results of the questionnaire were given to each director by the Chairman in appraisal meetings held in early 2018. The Vice Chairman conducted an appraisal of the Chairman's performance and it was concluded that he continued to provide strong and effective leadership of the Board.

The Non Executive Directors reviewed the performance of each Executive Director and Chief Officer through the completion of an internal questionnaire. This was used as part of the year end performance appraisal meetings of the Executive Directors and Chief Officers with the Chief Executive. The Chief Executive's appraisal meeting was conducted by the Chairman.

Conflicts of interest

One of the criteria which the Board takes into consideration when recruiting a Non Executive Director, including the Chairman, is their ability to have sufficient time to take on the position. In addition, during the term of their directorship with the Society any other external positions that a director takes up have to first be referred to the Board so that the time commitment and any potential conflict of interest can be considered. The Board has a Conflict of Interest Policy which sets out procedures for regularly reviewing, through the Board Governance and Nominations Committee, and if appropriate, authorising any potential conflicts as they arise. This applies to Executive Directors and Chief Officers, as well as Non Executive Directors.

Time commitment

The letters of appointment of Non Executive Directors give an indication of the time commitment required, taking into account any roles they are appointed to, however, this may be subject to change dependent on any additional Committee member or chairman roles undertaken in the future. The time commitment for the Committee Chairs is expected to be significantly greater than that of Committee members. The commitment will also increase, inevitably, when a significant transaction or development is being considered.

Copies of the letters of appointment of each of the Non Executive Directors are available for inspection on request from the Group Secretary.

Induction and development

The Chairman ensures that all Non Executive Directors receive a comprehensive tailored induction programme on appointment which provides an introduction to the Group's business and the regulatory environment. The progress of the induction programme is monitored by the Board Governance and Nominations Committee until completion. The Chief Executive also ensures that a tailored induction programme is provided for all Executive Directors.

All Non Executive Directors update their skills, knowledge and familiarity with the Group through internal presentations by senior managers, relevant external and internal presentations and training and through branch visits and attendance at member events which are referred to below. For example, during 2017 the Board has had a number of training sessions in relation to the IRB approach, diversity and inclusion and completed online learning on key topics such as whistleblowing. In November 2017, the Board Governance and Nominations Committee agreed an overall Training Plan for the Board which documents the training to be provided throughout the year ahead.

Individual training requirements for Non Executive Directors are discussed as part of the performance evaluation process with the outcomes documented in a personal development plan. An annual training record for each Non Executive Director is maintained by the Group Secretary.

Non Executive Directors are encouraged to contact individual members of the Executive Team to discuss any queries that they may have and to undertake branch and department visits on an ad hoc basis in order to deepen their understanding of the business.

All directors have access to independent professional advice if required and have the benefit of appropriate liability insurance cover at the Society's expense. In addition, they have access to the advice and services of the Group Secretary, Simon Waite, who is responsible for ensuring that Board procedures are complied with and for advising the Board, through the Chairman, on governance matters.

Accountability

The Board is responsible for the systems of internal control. The Audit Committee Report on pages 58 to 60 sets out the internal control framework which is designed to safeguard member and Group assets and to facilitate the effectiveness and efficiency of operations which helps to ensure the reliability of internal and external reporting and assists in compliance with applicable laws and regulations.

The Board is also responsible for setting the Risk Appetite of the Group and ensuring that there is a robust system for risk management in place to ensure the security of members' funds. The Group's risk management framework is set out in the Risk Management Report on page 61.

The Board has delegated to the Audit Committee oversight of the relationship with the external auditor to ensure that they remain independent, objective and effective. Further details can be found in the Audit Committee Report on page 60.

Remuneration

The Board has delegated to the Remuneration Committee the policy on remuneration for the Chairman, the Executive Directors and other members of the Executive and the Leadership Teams. A review of its activities and the remuneration policy is set out in the Directors' Remuneration Report on pages 70 to 84.

Relations with members

Member engagement

The Society's owners are its individual members who are made up of its savers and borrowers, subject to a small number of exceptions. This is different to the shareholders of a listed company, whose owners may include institutional shareholders. The vast majority of the Society's customers are, therefore, its members and the Society encourages feedback from them on any aspect of the Society's activities. This feedback takes various forms, including 'Your time to talk' events which give members the opportunity to meet and ask questions of the Chief Executive, the Leadership Team and/or local branch colleagues. In 2018 we are looking to hold more of these events and extend the reach through online and social media channels, ensuring members can engage with us whichever way they prefer.

The Society also operates My Voice, our online research community. My Voice gives customers the opportunity to feedback on a variety of topics that really matter through regular collaborative discussions, quick polls and surveys. It enables the Society to have a dialogue with our customers about what they want, what we could do better and what they want us to keep doing and to help shape the future of the Group.

In addition, a monthly customer perception tracker with over 2,500 customers across all Group brands is undertaken to monitor the strength of the relationship customers have with the Group. The results provide a key performance indicator of customer advocacy (called the Net Promoter Score) which is monitored by the Board on a monthly basis. We also contact approximately 30,000 members every year through our customer experience and brand tracker surveys to understand how they perceive the organisation and how we can improve our products and services.

Annual General Meeting (AGM)

At the AGM, the Chairman, Chief Executive and Chief Finance Officer give presentations on the previous year's trading, financial performance and on future plans. At the 2017 AGM, the Chair of the Remuneration Committee also gave a presentation on the directors' remuneration.

The meeting provides an opportunity for members to question the Chairman, Chief Executive and other directors on the resolutions to be proposed at the meeting and on any other aspect of the Society's business. All directors attend the AGM (unless their absence is unavoidable) including the Chairs of all of the Board Committees.

All members who are eligible to vote at the AGM receive a proxy voting form, which includes a 'vote withheld' option, and a pre-paid reply envelope (unless they have opted to receive the AGM pack by email) to encourage them to exercise their vote through the appointment of a proxy if the member cannot attend and vote at the meeting. Members are also able to appoint a proxy online.

At the AGM, the Chairman calls for a poll on all resolutions so that all proxy votes are recorded. The results of the proxy votes, and the votes cast at the AGM, are published on the Society's website and in branches. A separate resolution is proposed on each matter, including a resolution on the Annual Report and Accounts.

Eligible members are asked to vote on a number of resolutions and in particular are entitled to vote on the election and re-election of all directors in accordance with the Society's Rules.

Relations with other investors

The Society also places great importance on maintaining a frequent dialogue with its providers of external capital and funding. As part of the annual results publication process, the Society conducts a series of investor meetings to provide a detailed briefing on its financial performance. These briefings are held with a wide range of institutional investors and analysts and are not restricted to existing providers of wholesale funds or capital. The presentation materials are available throughout the year on the Society's website. In addition, representatives of the Society's Treasury team conduct regular face-to-face meetings with external stakeholders in order to provide updates on the Society's performance and respond to market queries.

On behalf of the Board

John Heaps
Chairman
28 February 2018

Board Governance and Nominations Committee Report

As Chairman of the Board Governance and Nominations Committee, I am pleased to present the Committee's first separate report on the work of the Committee during 2017. This report is recognition of the increasingly important role the Committee has in ensuring that the Society has an effective Board supported by a strong governance structure.

Membership and attendees

The Board Governance and Nominations Committee is appointed by the Board and comprises three Non Executive Directors:

- John Heaps (Chairman of the Committee).
- Mark Pain.
- Alison Hutchinson (joined the Committee in April 2017).

Dame Kate Barker retired from the Committee in April 2017 following her retirement from the Board.

Attendance at meetings during 2017 is shown on page 49 and information on the skills, qualifications and experience of directors can be found in the biographies on pages 38 and 39.

The Committee invites Executive Directors, Chief Officers and members of the Leadership Team, as appropriate, to attend meetings when it is felt that this would help it to discharge its duties.

Roles and responsibilities

The Committee is responsible for:

- Reviewing the structure, size and composition of the Board including the required skills, knowledge, experience and diversity and making recommendations on any changes to the Board or to the membership of Board Committees.
- Considering the succession planning for directors and other senior executives (unless this is considered by all of the Non Executive Directors in respect of Executive Directors) taking into account the challenges and opportunities facing the Society and the skills and expertise needed on the Board in the future.
- Leading the appointment process for director roles for approval by the Board.
- Approving the Directors' Conflicts of Interest Policy and monitoring any potential conflicts.
- Approving the Board Diversity Statement.
- Reviewing the programme of training for the Board.
- Reviewing other governance arrangements and making recommendations to the Board, as appropriate.
- Monitoring developments in relation to corporate governance issues and where appropriate reviewing the potential impact on the Society and making any recommendations to be implemented.
- Making recommendations to the Board in respect of the re-election of directors, ongoing independence of Non Executive Directors and the process for Board and Committee annual evaluations.

In 2017 the Committee met four times to discuss matters within its terms of reference. The Committee's terms of reference can be found on the Your Society section of our website at ybs.co.uk/committees

Non Executive Director recruitment

The Committee is responsible for leading the recruitment process for Non Executive Directors which includes:

- Development of a role specification for the position which reflects the specific needs of the Board following a review of the existing skills matrix and future composition requirements of the Board.
- Appointment of an external search agency to develop a list of candidates for consideration by the Committee.
- Interviews by a selection panel with shortlisted candidates against the agreed person specification.
- Subject to relevant checks, recommendation to the Board to appoint the preferred candidate.

Dame Kate Barker, Non Executive Director, and David Paige, Chair of the Group Risk Committee and Non Executive Director, retired at the conclusion of the 2017 AGM. The process to identify a successor for David Paige commenced in 2016 with the intention of also strengthening further the risk and retail banking experience on the Board, whilst giving regard to greater diversity. The recruitment process was overseen by the Committee and supported by an independent search agency, JCA, which has no other connection with the Society. JCA is a signatory to the Voluntary Code of Conduct for Executive Search Firms in Board appointments, an industry standard which aims to redress gender balance and promote best practice.

In early February 2017, on the recommendation of the Committee, the Board approved the appointment of Neeta Atkar as a Non Executive Director and the new Chair of the Group Risk Committee. Neeta Atkar subsequently joined the Board on 25 April 2017.

In 2017 the Board agreed to commence a new recruitment process with a view to appointing an additional Non Executive Director to the Board to strengthen the existing skills and experience and support succession planning for future years.

Executive Director recruitment

The Board appointed Alasdair Lenman as Chief Finance Officer and Executive Director with effect from 4 December 2017. This appointment was made following a search undertaken by Egon Zhender, who have previously assisted the Society with the recruitment process undertaken for a new Chief Executive at the end of 2016 and the appointment of Stephen White, Chief Operating Officer, in February 2016. Egon Zehnder is a signatory to the Voluntary Code of Conduct for Executive Search Firms in Board appointments and has no other connection with the Society.

Committee evaluation

The Committee undertakes an annual review of its effectiveness in accordance with its terms of reference and good practice. The outcomes of the 2017 review were discussed at the Committee's meeting in November 2017 and as a result it was agreed that the Committee would hold an annual strategy session to enable an in depth review of Board composition and succession planning in addition to the oversight maintained at each Committee meeting.

Board governance

The Committee also has a key role in ensuring the Board is able to discharge its governance responsibilities. It maintains an ongoing oversight of forthcoming governance developments and their potential impact on the Group together with proposed actions for recommendation to the Board. These included the FCA consultation on extending the SMCR to all FCA regulated firms, corporate governance reform and the Parker Review into the Ethnic Diversity on UK Boards.

Further details on the Committee's role in relation to succession planning, diversity and inclusion, Board evaluation, conflicts of interest, induction and development can be found in the Corporate Governance Report.

The Committee's priorities for 2018 will include its ongoing oversight of succession planning to ensure continuity and stability on the Board in future years.

On behalf of the Board

John Heaps
Chairman of the Board Governance and Nominations Committee
28 February 2018

Audit Committee Report

Membership and attendees

The Audit Committee is appointed by the Board and comprises three independent Non Executive Directors. Membership and attendance during 2017 is shown on page 49.

Neeta Atkar, Gordon Ireland and I have recent and relevant financial experience gained through either current or previous roles, other current non executive directorships, and our relevant qualifications. The Committee as a whole has appropriate, relevant experience of the sector in which the Group operates. More information on the skills, qualifications and experience of the Committee members can be found in the Directors' Biographies on pages 38 and 39.

As I indicated last year, David Paige retired from the Committee at the 2017 AGM.

Alison Hutchinson stepped down from the Committee during 2017 and I would like to take this opportunity to thank Alison for her valuable contribution since she was appointed in 2015.

Neeta Atkar and Gordon Ireland joined the Committee during 2017.

During the year the Committee met five times. Where appropriate, meetings began with a private session between executive management and the members, and concluded with a private session between the Committee members and both the internal and external auditors.

The Committee invites the Chief Executive, Chief Finance Officer and Director of Internal Audit to attend the meetings along with other members of the Leadership Team where appropriate.

Roles and responsibilities

The roles and responsibilities of the Committee are set out in its Terms of Reference, which are reviewed and approved by the Board each year. They can be found in the Your Society section of our website ybs.co.uk/committees

We have reviewed the Institute of Chartered Secretaries and Administrators (ICSA) guidance note on 'Terms of Reference for Audit Committees' dated March 2017, and the revised Chartered Institute of Internal Auditors (CIIA) 'Guidance on Effective Internal Audit in the Financial Services Sector' dated September 2017, and approved changes to our Terms of Reference as appropriate.

Financial reporting issues and judgements

Our role in monitoring financial reporting is key to ensuring that all of our stakeholders maintain their trust in the Group. We are responsible for ensuring that the key accounting policies and key judgements supporting our financial statements are appropriate. We are supported by our external auditor, Deloitte LLP (Deloitte), in this endeavour.

During 2017, management reviewed changes to accounting standards and related guidance and confirmed to the Committee that no changes were required to accounting policies for the period.

We considered the following significant issues during 2017:

- Loan loss provisions. Management has reviewed the outputs of the loan loss provisioning models and subjected the results to additional provisioning overlays where they believed that the underlying credit risk facing the Group wasn't being reflected fully. The Committee reviewed and challenged the approaches used, assumptions adopted and the overlays applied by management and agreed with the overall level of provisions held.
- Run-off of fair values associated with acquired books. The Group has mortgage books which were acquired following the mergers with Chelsea Building Society and Norwich & Peterborough Building Society where the fair value inclusive of lifetime losses of these books on acquisition was estimated by management. As these acquired assets run off over time, any adjustments to their fair values are recognised in the Income Statement. The Committee reviewed all the judgements made in this regard and discussed these at length with Chief Officers and the Leadership Team and the external auditors. As a consequence, the Committee is comfortable that a cautious but appropriate approach has continued to be taken.
- IFRS9. The IFRS9 accounting standard sets out the requirements for the classification and measurement of financial assets, financial liabilities and some contracts to buy or sell non-financial items. It includes requirements on impairment and hedge accounting. The Committee has received regular progress updates regarding the Group's readiness to comply with IFRS9, is satisfied with the actions taken by management and will continue to oversee these activities.
- Hedge accounting. The Group holds derivative financial instruments to mitigate various risks as set out in Note 34 on pages 142 to 145. Where the requirements of hedge accounting are met, the changes in the value of these instruments, recognised in the Income Statement, may be offset by the corresponding changes in the value of the hedged items. The Committee has overseen management's control activities in this area including an ongoing programme of improvements being made following a review of hedge accounting processes. These improvements include a move from micro to macro hedging for the Group's retail mortgage assets in 2018. This oversight activity enables the Committee to be confident that amounts recognised in the Income Statement are fairly stated and that appropriate disclosures have been made.
- Other provisions. Management reviewed other provisions throughout the year with key changes reflecting an increase in the Payment Protection Insurance (PPI) and property-related provisions, and provision for restructuring costs, as well as a number of other, individually immaterial, customer remediation provisions. The Committee reviewed these provisions and agreed with the overall level held. The Committee's review of the provision for PPI took account of the estimated impacts of changes in regulation regarding eligible complaints.

- Revenue recognition. The Group recognises income in relation to the provision of mortgages on an effective interest rate basis. Fees and commissions are spread over the expected behavioural life of the mortgage. The Committee agreed with the assumptions used and concluded that revenue was fairly stated.
- Change programme. The Group has continued its significant investment in the change programme. The Committee has considered the approach being taken to cost allocation and is satisfied that the capitalisation of costs associated with the programme is appropriate.
- Viability and going concern. When preparing the Group's Annual Report and Accounts the directors are required to confirm that the Group is a going concern, unless it is inappropriate to presume that the Group will continue in business. In addition, the directors are also required to confirm the longer-term viability of the Group as set out in the Strategic Report on page 37. The Committee reviewed and challenged papers prepared by management and was in a position to recommend to the directors that the Annual Report and Accounts should be prepared on a going concern basis and that there is a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the next three years.

The Group's Annual Report and Accounts are required to be fair, balanced and understandable as well as providing the necessary information for members to assess the Group's position, performance, business model and strategy. The Committee reviews and recommends specific representations, to allow the Board to approve the Letter of Representation to the external auditor and advises the Board whether it considers the Annual Report and Accounts to be fair, balanced and understandable.

The Committee is satisfied that, taken as a whole, the Annual Report and Accounts is fair, balanced and understandable.

Internal controls

The Board recognises the importance of sound systems of internal control in the achievement of its objectives and the safeguarding of member and Group assets. Internal control also facilitates the effectiveness and efficiency of operations, helps to ensure the reliability of internal and external reporting, and assists in compliance with applicable laws and regulations.

The Group operates in a dynamic business environment and, as a result, the risks it faces are continually changing. The internal control framework has been designed to ensure thorough and regular evaluation of the nature and extent of risk and the Group's ability to react accordingly. It is the Board's responsibility to develop policies on risk and control. All colleagues have responsibility for internal control as part of their accountability for achieving objectives. Colleague training and induction is designed to ensure that they are clear on their accountabilities in this area and are competent to operate and monitor the internal control framework.

We review this framework through regular reporting from Chief Officers, the Leadership Team, Internal Audit and our external auditors who set out the views of management as well as their own independent opinions. The Committee works closely with the Group Risk Committee ("GRC") to ensure the risk assurance framework is operating effectively throughout the business.

Further details of actual risk management practices are provided in the Risk Management Report on pages 61 to 69.

The main internal control areas considered during 2017 were:

- Internal audit reports. The Committee approved the Internal Audit plan for the year, the proposed revisions to that plan and the resource needed to support it. It received reports on the outcomes from the delivery of the plan. The Committee considered an annual report giving an overall assessment of the effectiveness of internal control.
- Our external auditors provide us with internal control reports in respect of key financial reporting processes and systems arising from the external audit review. During the year, Deloitte did not highlight any material control weaknesses.
- We regularly review updates on the status of issues raised in control reports, both from our internal and external auditors. The volume and age profile of control issues has remained within tolerable limits.

The Committee has received regular reports on the use of the confidential reporting channels in the Group to enable effective oversight of any concerns raised by colleagues and stakeholders.

The information considered by the Committee provided assurance that in 2017 the Group maintained an adequate internal control framework that met the principles of the UK Corporate Governance Code, and that there were no material breaches of control or regulatory standards. However, there were a number of control improvements identified by management that will be actioned in 2018 and monitored by the Committee.

Oversight of Internal Audit

The Committee receives regular reports from Internal Audit setting out the results of their assurance activity including their performance against a range of measures. The function reports annually on the skills and resources necessary to discharge its role, and its plans are approved by the Committee.

The Internal Audit function is governed by a Charter which is reviewed annually by the Committee and was reapproved in October 2017. A copy of the Charter can be found on the Group's website ybs.co.uk/your-society/inside-your-society/corporate-governance/committees.html The Director of Internal Audit reports directly to me, and Internal Audit has full and unrestricted access to all functions, systems, records and colleagues.

Audit Committee Report continued...

Internal Audit has deployed an internal quality assurance programme that meets the requirements of the CIIA 'Guidance on Effective Internal Audit in the Financial Services Sector'. The Committee has previously also commissioned external expert assessment of Internal Audit. The Committee considered the outputs from these sources which have assisted its ongoing assessment of the effectiveness, quality, experience and expertise of the Group's Internal Audit and its approach.

Through the ongoing strategic plan for the function, we continue to build Internal Audit to ensure it is appropriate for the role it plays in the Group risk environment. This has included, during the year, appointing a new Director of Internal Audit, Suzanne Clark, who has extensive experience of internal audit in the financial services sector.

Oversight of external audit and the external audit process

Each year the Committee approves the proposed audit plan presented by the external auditor, including a discussion of key risk areas to ensure that there is agreement on the focus of work and materiality measures.

The external auditor provides regular reports to the Committee on their work on the Interim Financial Statements and the Annual Report and Accounts prior to the Committee recommending approval.

The Committee carries out an assessment of the effectiveness of the external audit process each year. This follows a process based on practice aid guidance from the (Financial Reporting Council) FRC. The assessment is informed by the perceived value extracted from engagement with the external audit team and process, based on responses to a questionnaire issued to members of the Committee and management in the Finance Division. During the year, the Committee concluded that overall the external audit process was effective and an action plan was agreed for areas identified for improvement.

The Committee takes into account the performance of the external auditor when considering their reappointment as well as their length of tenure and the date of rotation of the audit partner. Deloitte were appointed in July 2009 following a competitive tender process and the external audit partner rotated off the audit following the 2013 year end. Peter Birch, the current external audit partner, rotated onto the engagement for the 2014 year end.

External auditor objectivity and independence

The Group has a policy on the use of the external auditor for non-audit work, which is overseen by the Committee. The purpose of this policy is to ensure the continued independence and objectivity of the external auditor. The policy sets out examples of services which the external auditor can and cannot perform. Fees for individual assignments which exceed pre-defined limits require prior notification to the Chairman of the Audit Committee, who then considers whether formal Committee approval is required. The level of fees incurred is regularly monitored, and the Committee is satisfied that the Group has operated in compliance with the policy during 2017. There are no significant non-audit engagements that require explanation as to why the external auditor was used.

Details of the fees paid for non-audit services during the year can be found in Note 7 on page 110.

Audit Committee effectiveness

The effectiveness of the Committee is assessed annually. A self-assessment exercise, co-ordinated by Internal Audit, is performed and the results are reported to the Board. The 2017 review concluded that the Committee operated effectively during the year. Areas were identified for further development and action is being taken to address them.

Committee members are expected to undertake relevant training as part of their ongoing development as an individual Board member. The approach to this development, overseen by the Board Chairman, is set out in the 'Induction and development' section of the Corporate Governance Report on page 54. Each year, as well as undertaking individual training as members consider appropriate, the Committee receives training on current topics. In 2017 this comprised updates on Hedge Accounting and IFRS9 and used a combination of external and internal specialists to include both industry developments and application within the Group.

On behalf of the Board

Mark Pain
Chairman of the Audit Committee
28 February 2018

The purpose of this Risk Management Report is to describe the Group's approach to the management of risk through its Enterprise Risk Management Framework (ERMF) and to set out the principal risks to which the Group is exposed.

Enterprise Risk Management Framework

Introduction

The Group recognises that for the business to grow and achieve its commercial aspirations, effective risk management is essential. The key elements of risk management encompass the activities relating to the assessment, control, monitoring and reporting of risk.

During 2017 the Group updated its ERMF in order to further improve robust yet efficient risk management which has an important and integral role in the Group:

- Delivering against its strategy within an appropriate culture;
- Protecting itself against unplanned financial outcomes;
- Building greater resilience to organisational threats;
- Protecting its customers from unfair outcomes; and
- Demonstrating its credibility to external stakeholders.

The ERMF explains how a variety of processes fit together to create a consistent and effective way of managing risk across the Group. It is reviewed and approved annually by the Group Risk Committee and consists of:

- Risk vision and strategy – the Group's vision for risk management and what we need to do to achieve it.
- Group culture – the values and behaviours that shape our risk decisions.
- Risk appetite – how much risk we can take in order to deliver the Group strategy while ensuring fair customer outcomes.
- Policy and governance – how we organise ourselves, make decisions and take approved risks.
- Risk assessment and control – how we understand our risks and limit undesirable outcomes from occurring.
- Risk events – how we respond when things go wrong and stop the same things happening again.
- Monitoring and assurance – how we check that controls are working and highlight when risks require attention.

Three Lines of Defence

The Group operates a Three Lines of Defence (LoD) approach towards risk management which seeks to differentiate between those:

- with direct responsibility for the management and control of risk.
- with oversight responsibility across the effectiveness and integrity of the ERMF.
- providing independent assurance across the first and second LoD. A summary of these respective responsibilities is set out below.

First Line of Defence

Risk category owners (Colleagues who determine how a particular group of risks should be managed):

- Articulate risk(s) in Group Risk & Control Library.
- Design key controls.
- Direct Group policy.
- Oversee Group management of specific risk(s).

Directors/Business functions
(Colleagues who are responsible for ensuring risks are effectively managed):

- Identify relevant risks from Risk & Control Library in risk register.
- Own risks relevant to business function.
- Operate applicable key controls and develop and operate supplementary controls as necessary.
- Assess risks and controls and determine if further actions are required.

Second Line of Defence

The second LoD defines the Group's approach towards risk management and supports, coaches, facilitates, independently monitors, challenges, reports and if necessary gives direct instruction to the first LoD. Second line is responsible for managing our regulatory relationships and for providing briefings to the Board in this respect.

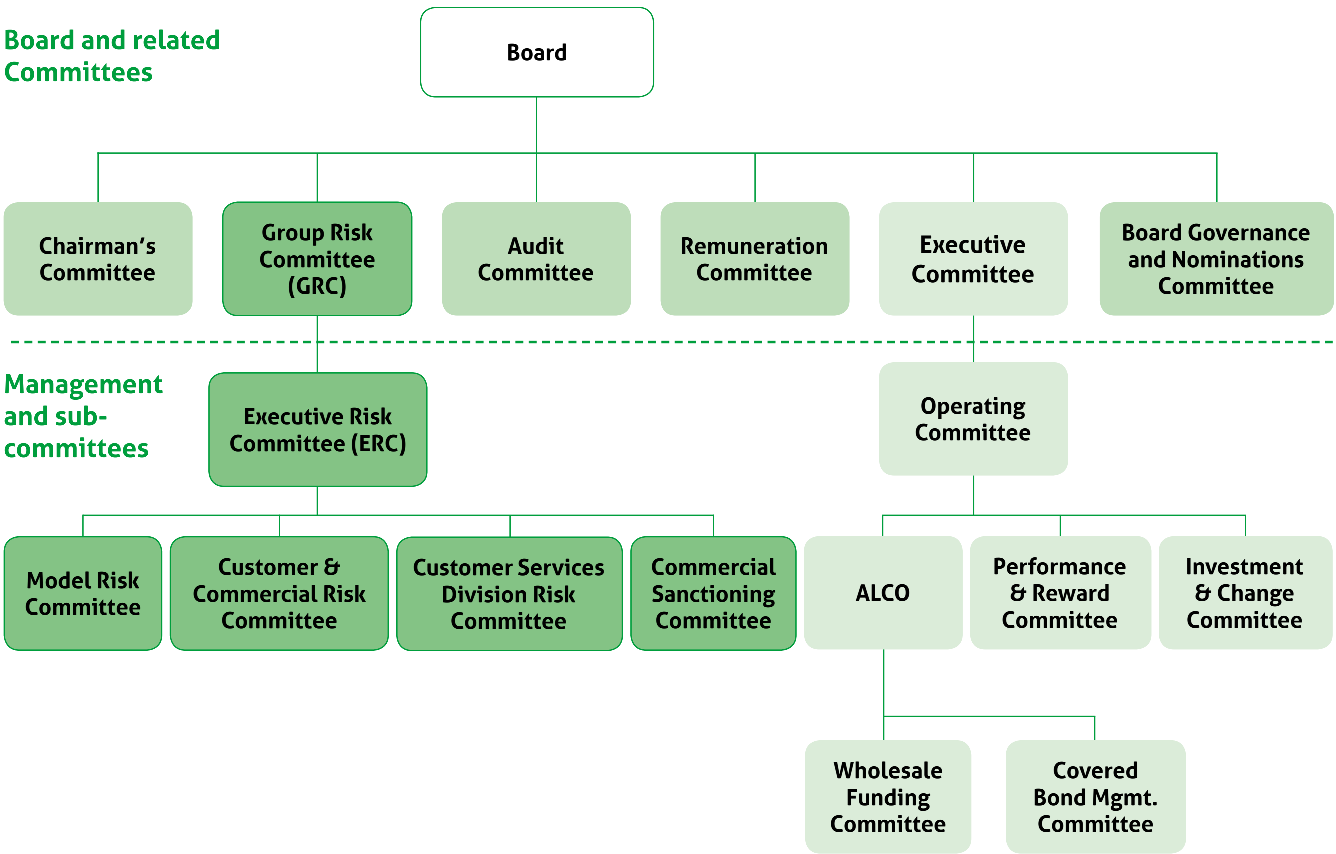
Third Line of Defence

Third line independently assesses whether the risks are adequately controlled, challenging the Executive Team to improve the effectiveness of governance, risk management and internal controls. Internal Audit reports directly to the Audit Committee which is a Board committee.

Risk Management Report continued...

Governance

During 2017 the Group restructured its governance arrangements and committee structure in line with changes to the organisational design. The Group's Board and senior management committee structure is illustrated below, with risk committees duly highlighted.



The Board is ultimately responsible for the effective management of risk. The approval of risk appetite and associated high level risk strategy are amongst a number of specific areas which are matters reserved for the Board.

Group Risk Committee is a Board committee that reviews, on behalf of the Board, the key risks inherent in the business and the system of control necessary to manage such risks, presenting its findings to the Board.

Executive Risk Committee is responsible for the oversight of day-to-day risk management activity including, but not limited to, review of the effectiveness of the Group's risk management framework and system of internal controls. It has authority to direct the business in relation to mitigating actions and to approve or endorse risk acceptance within defined levels.

Below the Group's Board and senior management committee structure is a set of **Divisional Risk Committees**. These committees oversee risk management activity across the Group's core divisions, acting as the point of escalation for matters of Group level significance. Again, the Committees have authority to direct mitigating actions and to approve or endorse risk acceptance for risks within the Division, in accordance with defined levels.

Group Risk Committee

The Group Risk Committee oversees the Group's risk management framework and assists the Board by providing an enterprise-wide perspective on all risk matters. It normally meets four times a year, but will meet more frequently when the need arises. As Chair of the Committee, I provide regular updates to the Board on matters considered by the Committee.

In addition to myself, the Committee's membership comprises three other Non Executive Directors: Mark Pain, Alison Hutchinson and Gordon Ireland. It is also attended by members of the Executive Team including the Chief Executive Officer, the Chief Operating Officer, the Chief Customer Officer, the Chief Finance Officer, the Chief Risk Officer and the Director of Internal Audit. The Committee invites certain members of the Leadership Team when it is felt that this would help it discharge its duties. The Committee's Terms of Reference are available from the Corporate Governance section of our website at ybs.co.uk/committees

The Group maintains an independent second line risk management function (Group Risk) that is responsible for ensuring that appropriate risk management and measurement techniques are used that are commensurate with the Group's strategic aims, its appetite for risk and the actual risks it faces at any time. The Group Risk function ensures that the Group Risk Committee receives a comprehensive programme of decision papers and reviews to ensure that it is fully sighted on such matters. The Group's Chief Risk Officer provides a formal update to the Board and to the Group Risk Committee on a quarterly basis covering all areas of risk management, including routine reporting, emerging risks, the results of his team's independent oversight and ad hoc issues that merit escalation.

During 2017 the Committee met four times and the matters considered included:

Approval of:

- Enterprise Risk Management Framework and Strategy.
- Risk appetite setting ahead of approval by the Board.
- Lending and Financial Risk policies ahead of approval by the Board.
- Financial Crime, Regulatory Risk and Stress Testing policies.
- Regulatory Capital submission Internal Capital Adequacy Assessment Process (ICAAP) ahead of approval by the Board.
- Regulatory Liquidity submission Individual Liquidity Adequacy Assessment Process (ILAAP) ahead of approval by the Board.
- Appropriate stress testing including Reverse Stress Tests.
- Recovery Plan and Resolution Packs.
- Three LoD capability update.
- Second LoD oversight plans (compliance and conduct, prudential, operational).
- Approval of the reintroduction of interest only mortgage products, as it required a change to risk appetite.
- Business overlay (risk) process for Material Risk Takers' bonus/other variable benefits.
- Money Laundering Reporting Officer's annual report.
- Delegation of mandates to sub committees.

Monitoring of:

- Economic, political, market and cyber risks and their potential impact on risk appetite.
- The Group Risk Map including the Horizon Risk Register.
- Risk appetite adherence.
- Second LoD monitoring of compliance and conduct risk, prudential risk and operational risk.
- The project to implement the IRB approach to capital requirements for retail credit risk.
- Effectiveness of the Three LoD model, including resourcing and capability of the first and second LoD.
- A cyclical programme of deep dives into key areas. Examples included compliance and conduct risk, credit risk, control self-assessment, financial crime, PSD2, and market and treasury risk.
- In addition to the deep dives, specific ad hoc topics are considered at the request of the Committee. In 2017 these included:
    - Operational resilience.
    - Implications of the UK exiting the EU on the London housing market and other risk concentrations.
    - Changes to liquidity investment strategy.
    - Operational continuity in resolution.
    - Non-maturity hedging.
    - Interest only lending.
    - Third party risk.

Risk Management Report continued...

Principal risks

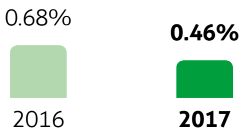
During 2017 the Group developed a risk category model comprising four 'Level 1' risks and 26 'Level 2' risk categories, as illustrated below.

Level 1	Operational Risk	Compliance & Conduct Risk	Prudential Risk	Business Risk
Level 2	Business Continuity Risk	Customer Treatment Risk	Balanced Interest Margin Risk	Business Model & Strategy Risk
	Change Risk	Product Governance Risk	Capital Risk	Media Relations Risk
	Financial Management, Reporting & Tax Risk	Sales Suitability Risk	Wholesale Credit Risk	Legal & Governance Risk
	Health & Safety & Physical Assets Risk	Complaints & Redress Risk	Funding & Liquidity Risk	Financial Sustainability Risk
	Information Management Risk	Reward & Incentivisation Risk	Pension Funding Risk	
	Information Security Risk	Financial Crime Risk	Retail & Commercial Credit Risk	
	IT Risk			
	Payments Risk			
	People Risk			
	Third Party Risk			

Our risk profile evolves as we move through the economic cycle. Set out below are the principal risks or risk categories that currently impact the Group. We have also explained how we manage and measure the risk, along with progress achieved in 2017:

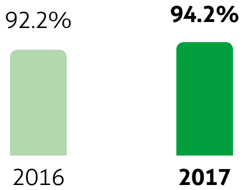
Retail and commercial credit risk

The risk of customers defaulting on repayments, leading to credit losses as a result of failure to design, implement and monitor an appropriate credit risk appetite.

Risk mitigation	Key risk indicators	Commentary
▪ Retail and Commercial credit risk is constrained by a Board approved risk appetite, which is further governed through the Retail and Commercial Lending Policy. ▪ A robust credit risk framework helps to ensure that lending remains within risk appetite limits. Adherence is monitored regularly through governance committees. ▪ Stress testing confirms portfolio resilience. ▪ Credit risk metrics are benchmarked against competitors and industry averages.	**Mortgages arrears ≥ 3 months by value**  	▪ 2017 has seen continued improvements in arrears performance and favourable HPI movements. ▪ The PRA has confirmed that the Group is operating on the 'Mitigated' approach to lending as described in SS20/15. ▪ Investment has been made to ensure compliance with regulatory change, most notably around residential mortgage affordability stress tests and Buy-to-Let mortgages. ▪ In 2018 the credit risk focus will mainly be continued delivery of strong asset quality aligned to responsible growth of the mortgage book.

Wholesale credit risk

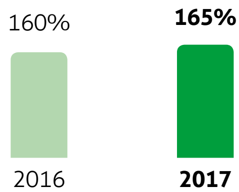
The risk of credit losses following default on exposures arising from operational balances with other financial institutions, liquid asset holdings and the use of derivative instruments to manage interest rate and foreign exchange risk.

Risk mitigation	Key risk indicators	Commentary
▪ Wholesale credit risk is constrained by a Board approved risk appetite, which is further governed through the Treasury Risk Policy. ▪ Most of the Liquid Asset Buffer portfolio is invested in the highest quality assets. ▪ The majority of derivative contracts are subject to centralised clearing to minimise credit risk exposures to counterparties. Where this is not possible, derivative exposures are restricted to high quality counterparties which are subjected to regular review and scrutiny by the Finance Risk Committee within overall risk limits authorised by the Group's Executive Risk Committee.	**Wholesale AA- or above**  	▪ Each wholesale counterparty limit is reviewed at least on an annual basis, or sooner if a risk event occurs in the interim. ▪ The size of the credit limit allocated per counterparty is driven by their credit status as determined by internal analysis and is calibrated to the size of the Group's capital position to ensure that the financial viability of the Group is not overly exposed to any single counterparty.

Risk Management Report continued...

Funding and liquidity risk

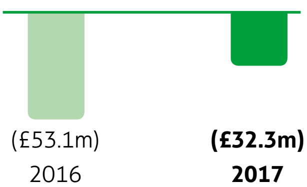
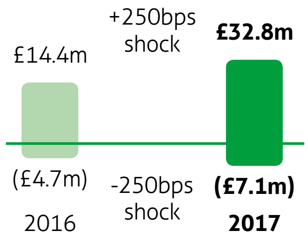
The risk of the Group having inadequate cash flow to meet current or future requirements and expectations.

Risk mitigation	Key risk indicators	Commentary
• Liquidity and funding risk is constrained by a Board approved risk appetite, which is further governed through the Liquidity and Funding Policy. • The key assumptions, risks and controls around the management of liquidity risk are outlined in the ILAAP document which is approved annually by the Board. • The Group operates a range of internal stress tests to ensure that sufficient liquidity is available at all times to address stress and business as usual requirements. • The Group also manages to the external regulatory measure, the Liquidity Coverage Ratio (LCR). • The Group is primarily funded through retail savings balances, supported by a strong franchise in key wholesale funding markets.	**Liquidity Coverage Ratio** 	• The LCR as at the end of 2016 was 160% with the position at the end of 2017 at 165%. This has predominantly been driven by an increase in funding through the government's Term Funding Scheme (TFS) providing additional liquidity.

Market risk

Repricing Mismatch Risk: The risk that the value of, or income derived from, the Group's assets and liabilities changes unfavourably due to movements in interest rates and foreign currency rates. Interest rate mismatch risk arises from the different re-pricing characteristics of the Group's assets and liabilities.

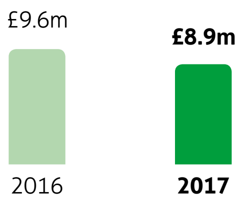
Basis Risk: Basis risk arises from possible changes in spreads where assets and liabilities re-price at the same time, but move in differing amounts causing unfavourable impacts to earnings.

Risk mitigation	Key risk indicators	Commentary
▪ Market Risk is constrained by a Board approved risk appetite, which is further governed through the Market Risk Policy. ▪ The Group adopts a risk averse approach to interest rate mismatch although some scope for position taking is allowed in line with an agreed in house rate view, subject to the agreed risk appetite. ▪ The Group operates a wide range of measures and scenarios that review this risk in respect of both earnings and value. Earnings are stressed over a 12 month period for +/- 250bps changes in rates. Rates are assumed to floor at 0%. ▪ The Group's limits for basis risk include limits for sensitivities around isolated movements in underlying rates (LIBOR/SONIA), for overall mismatch ratios and for ensuring the Group has sufficient levels of margin management capability.	**PV200 Market Value**  **12 Month Earnings Sensitivity**  	▪ The PV200 (Market Value change on Group Balance Sheet of a parallel 2% increase in interest rates) has decreased year on year (point position at year end) due to decreased utilisation of risk limits against the approved internal rate view. ▪ The increase in the 12 month earnings sensitivity is driven primarily by a change in the Group's discretionary risk position within Treasury within this time period.

Risk Management Report continued...

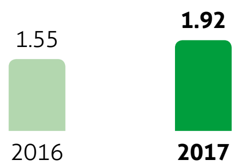
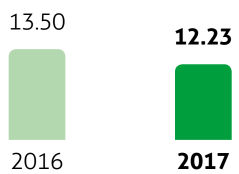
Operational risk

The risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems, or from external events.

Risk mitigation	Key risk indicators	Commentary
• Operational risk is constrained by a Board approved risk appetite, which is further governed through the ERMF. • The ERMF sets out how colleagues are expected to identify, assess, monitor, manage and report their risk exposures. • A Risk & Control Self-Assessment process outlines the controls that must be followed and the frequency of assurance in order to determine whether the current set of controls is appropriate to manage its risks going forwards. • The Executive Risk Committee provides oversight across the Group's operational risk exposures. • 2LoD review and challenge in relation to framework adherence or other risk related matters is carried out through formal oversight reviews in accordance with the combined 2LoD oversight plan.	**Operational Losses** 	• A new Enterprise Risk Management function was established in Q4 2017 which follows resourcing upgrades of the previous Operational Risk and Internal Control function during 2016. • Following the Group-wide review of the organisational design, a business governance review was carried out resulting in a more effective and efficient committee structure, including the implementation of a new Executive Risk Committee. • Both a new Enterprise Risk Management Framework and Group Risk Management Strategy have been upgraded and approved in Q4 2017, replacing the former Enterprise & Operational Risk Management Policy Risk Management Strategy & Framework. • Key developments planned for 2018 include baselining of the Group's functional risk registers, followed by the embedding of the new Risk & Control Self-Assessment process.

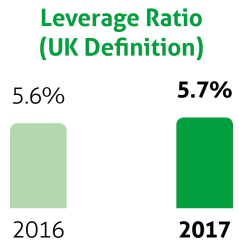
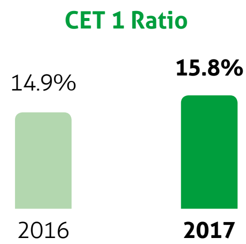
Compliance and conduct risk

The risk of direct or indirect loss as a result of a failure to comply with regulation or to ensure fair customer outcomes.

Risk mitigation	Key risk indicators	Commentary
• Conduct risk is constrained by a Board approved risk appetite, which is further governed through the Conduct Risk Strategy and Group Risk Management Policy. • Key conduct risk metrics are in place through our conduct risk MI book to manage and monitor the key conduct risks within the Society. • The Group is committed to ensuring that it has effective processes and procedures to counter the risk of bribery and corruption. A formal anti-bribery and corruption policy is in place and all colleagues are required to undertake appropriate training annually.	**Complaints per 1,000 accounts – Banking, Savings & Loans (H2)**  **Complaints per 1,000 accounts – Mortgages (H2)** 	• A compliance monitoring plan, agreed with Group Risk Committee, has been completed during 2017 allowing robust oversight of the key areas of conduct risk with action plans agreed for all areas of weakness identified. • Clear responsibilities have been determined in a revised governance model that established defined risk management and oversight accountability within the divisions and executive risk committees.

Business risk

The risk of direct or indirect loss as a result of the pursuit of inappropriate strategy or a failure to effectively manage the Group's corporate affairs.

Risk mitigation	Key risk indicators	Commentary
■ Capital risk is constrained by a Board approved risk appetite, which is further governed through the Capital Strategy. ■ Current and projected capital positions are regularly monitored and also considered in stress scenarios as part of the ICAAP. ■ Specific details on capital management can be seen in the Group's Pillar 3 disclosures (available on the Group's website).	 	■ All key capital ratios including the leverage ratio increased from 2016 to 2017 and remain above both regulatory requirements and internal risk appetite levels. The leverage ratio presented uses the Bank of England's revised exposure criteria which excludes central bank deposits from the exposure measure. ■ The Group maintains a strong capital position both currently and in forecast, while developing its capability to move to an IRB method of calculating capital requirements for credit risk and preparing for upcoming regulatory changes including the finalisation of Basel III and the implementation of a MREL.

Stress testing

Stress testing is a risk management tool used throughout the Group to better understand potential vulnerabilities in our business model. Group Risk Committee approves key stress tests. The key uses of stress testing are:

- To test the robustness of the Group's financial plan.
- To support regulatory returns, ICAAP and ILAAP.
- Scenario analysis in the Group's recovery plan.
- Daily stress testing of liquidity and market risk.
- The Group's annual reverse stress tests.

Reverse stress tests start from the identification of a predefined outcome, that being the point at which the firm's business model becomes unviable, or at which the firm can be considered to be failing because the market has lost confidence in it. They are helpful in contingency planning and to reveal weaknesses which may not be evident from other forms of stress testing.

Further information on risk and risk management can be found in the Strategic Report (Principal risks and uncertainties on pages 35 to 36), including the most significant emerging business and operational risks the Group is continuing to review. The Pillar 3 Disclosure Report, which contains details on capital requirements, including Pillar 1 requirements and descriptions of risks considered for Pillar 2 requirements, and the following notes to the accounts: Conduct Risk (Note 28), Capital Risk (Note 31), Liquidity and Funding Risk (Note 35), Market Risk (Note 36) and Credit Risk (Notes 38 and 39) all contain detail on risks and risk management.

Future developments

Good progress has been made in 2017 on enhancing the Group's approach to risk management and measurement, including developing further the ERMF, a risk and control library and an enhanced Risk Management Strategy. We will continue this programme during 2018, when enhancements will include:

- Completion of improved Risk Registers across the Group.
- Developing and implementing steps towards an integrated assurance approach.
- Developing and implementing a new Risk & Control Self-Assessment (RCSA) process.
- Delivering further improvements to risk reporting, based on the results of the RCSA process.

On behalf of the Board

Neeta Atkar
Chair of the Group Risk Committee
28 February 2018

Directors' Remuneration Report

Letter from the Chairman of the Remuneration Committee

Dear Member,

I am pleased to share the Directors' Remuneration Report, including details of the directors' pay, for the year ended 31 December 2017.

Our approach to remuneration

In 2017 the Group reconfirmed its purpose: to provide real help with real life by being simply brilliant at mortgages and savings. Furthermore, as a mutual, we strive to operate a transparent remuneration policy that reflects the values of our organisation and extends to all colleagues. Our approach to remuneration focusses on more than just base pay. Rather, it ensures reward and benefit arrangements are fully integrated in what we do every day.

We review our reward policy and principles annually and they are published online for all colleagues and members ybs.co.uk/pdf/financial/reward-policy.pdf

To attract and retain talent required in the Group, the Committee seeks to balance the need for total remuneration to be competitive in the wider financial services sector, whilst remaining commensurate with our mutual status. We make a conscious decision to operate a lower level of performance related pay (bonus) than many of our competitors, capping our bonus potential at 50% of base salary (more than 50% lower of the regulatory maximum). When setting targets for the scheme, we always seek to drive performance that benefits the Group and its members, ensuring a sustainable business over the long-term, which is true to our heritage and values, for the coming years.

Our remuneration policy

We recognise that the way colleagues are rewarded and motivated is a cornerstone of a leading people experience. Our remuneration policy is in place to support our colleagues in working together for the benefit of the Group and our members. At the 2016 AGM, our Directors' Remuneration Policy was approved by our members (through an advisory vote), and it continues to set the framework for our directors' remuneration. A summary of the policy is set out in this report. In line with good governance, our remuneration policy for executive directors will next be shared with members for approval (through an advisory vote) at the 2019 AGM.

Executive Director changes

Our Chief Finance Officer, Robin Churchouse, left the Group in September 2017 after 13 years' service. Robin has made a huge contribution to the Group, playing a key role in the mergers with Chelsea, Barnsley and Norwich & Peterborough Building Societies.

In December 2017 we welcomed Alasdair Lenman as the new Chief Finance Officer for the Group. At the 2018 AGM, Alasdair will be subject to the election process as an Executive Director.

Details regarding the remuneration implications of these changes are in line with the Directors' Remuneration Policy and are set out in full in this report.

How the Group has performed

Throughout 2017 the industry experienced the pressures of a competitive trading environment coupled with economic uncertainty. We have managed this in a sustainable and balanced way. As set out earlier in the Annual Report, 2017 was a strong year for the Group. We remain committed to putting the needs of our members at the heart of everything we do; a performance measure of this commitment is the Group's Net Promoter Score (NPS). During 2017 we achieved a score of +41 versus a target of +35, recognising the developments we have made across all our product and service lines. The Group has also delivered a strong financial performance, outperforming its plan performance in a number of areas detailed on page 17.

The impact of performance on directors' pay

The Group's results have been reflected in the directors' remuneration awarded for 2017. The remuneration of our executive directors reflects their contribution to, and is aligned with, the success of the Group. As with previous years, the Committee has carried out a comprehensive review of the remuneration outcomes of the executive team, considering these in the context of wider colleague pay in the Group, both in relation to financial performance and delivery to our members and customers. In 2017, (on average) an eligible Executive Director achieved 80.0% of their maximum bonus opportunity, with all eligible colleagues receiving an average of 66.4% of their maximum opportunity. The Group's bonus is awarded on successful achievement of financial and customer performance measures combined with individual performance. An 'at a glance' summary is provided on page 72 and further details of how payments have been calculated for executive directors are outlined in this report.

Base salary increase for employees in 2017

Across the Group (including all Executive Directors), the average base salary increase was 2.5%.

Base salary increases for executive directors in 2017

Our Executive Directors are subject to a review of their base salary each year in line with all colleagues. As detailed in last year's report, Mike Regnier became Chief Executive Officer on 1 January 2017 and his remuneration was adjusted at that time to reflect this. His base salary will next be reviewed in 2018. Stephen White (Chief Operating Officer) received an increase to base salary of 2.75% during 2017. This was in line with policy applied to all colleagues.

Looking ahead to 2018

Our focus continues to be on providing value to our members by delivery of high levels of customer service and building a sustainable business for the future. The committee is focused on incorporating colleague and member views into its remuneration policy and practice. Throughout 2017 the Committee has increased colleague engagement in reward policy through focus groups, colleague surveys and 'Let's Talk' sessions (colleague listening groups hosted and attended by Executive Directors and Non Executive Directors). We also published our reward policy and principles internally for the first time. The Committee plans to continue and develop this work in 2018, exploring how we can better engage colleagues and members to contribute to the shaping of a remuneration policy that supports the delivery of the Group's purpose, ensuring it is aligned to our values.

Gender pay gap

In November 2017 the Group reported its gender pay gap, the difference between the average pay of men and women regardless of seniority. The Group's mean gender pay gap at April 2017 was 31.0%. Analysis shows that the key driver for the gap is the imbalance in the numbers of women and men at different levels in the organisation. In simple terms there are more females occupying less senior roles in the organisation, with fewer in the most senior roles. It is this imbalance that results in the gender pay gap. If YBS Group had an equal (50:50) split of males and females at each level, the gap would be much lower at 3.5%. The full gender pay gap report is available at ybs.co.uk/assets/pdfs/your-society/comitees/gender-pay-gap-report.pdf. The Group strives to create an environment where diversity in all forms is encouraged and barriers in the way of colleagues fulfilling their potential are removed. As the Remuneration Committee we contribute to this by ensuring that the Group's remuneration policy is inclusive in both its design and practice.

Director remuneration reporting requirements

This report discloses information in line with the Building Societies (Accounts and Related Provisions) Regulations 1998; and the Pillar 3 disclosure requirements under CRD IV relevant to a Proportionality Level 2 firm. The Group also voluntarily complies, where possible, with the disclosure requirements of the Large and Medium-sized Companies (Accounts and Reports) Regulations 2008.

I trust that members will agree that the performance of the Group and its leaders in 2017 warrants your continued approval of the Annual Report on Remuneration. On behalf of the Remuneration Committee, I recommend that you endorse the report.

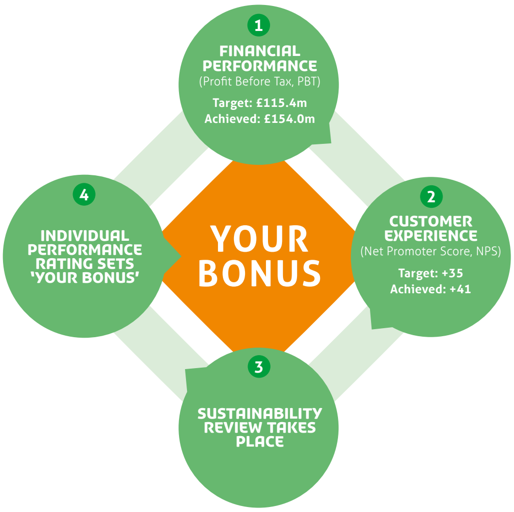
Guy Parsons
Chairman of the Remuneration Committee
28 February 2018

Directors' Remuneration Report continued...

At a glance summary of 2017

The summary below outlines the structure of the Group's bonus scheme, 'Your Bonus' and the performance measures taken into account to calculate the Executive Directors' bonus awards.

The Group's performance used for bonus calculations



*The PBT figure for 'achieved' is different to the figure stated on page 30 of the Annual Report and Accounts. This figure is adjusted to reflect underlying profit and is in line with agreed principles which are outlined on page 78 of this report. The NPS measures how likely customers are to recommend us and is a combination of customer and broker NPS, resulting in an achieved NPS of +41.

The scheme design is the same for all colleagues, with varying on-target award levels for colleagues and senior managers. Bonus is awarded on successful achievement of financial and customer performance measures, combined with individual performance. 'On-target' achievement of Group performance and individual performance criteria in line with expectations results in a bonus of 30% of base salary for the Executive Directors. The maximum bonus available to Executive Directors is 50% of base salary.

The Remuneration Committee retains the discretion to make adjustments to the profit figure to ensure that it reflects a true view of the underlying performance of the Group prior to the payment of any bonus. In line with our directors' remuneration Policy, the Committee undertakes a risk overlay process (part of the sustainability review) on bonus based on a series of agreed criteria. These are detailed in the report.

How much have our directors earned in 2017?

The summary below illustrates executive director total earnings for the 2017 performance year.

		Base Salary £000	Other Fixed Pay[3] £000	Bonus £000	Total Earnings £000
Mike Regnier	CEO	550	105	275	930
Robin Churchouse[1]	Former CFO	275	54	56	385
Alasdair Lenman[2]	New CFO	27	7	–	34
Stephen White	COO	407	96	204	707

1 Robin Churchouse left the Group on 30 September 2017. His payments reflect his service in 2017.

2 Alasdair Lenman joined the Group on 4 December 2017 and his payments reflect his length of service with the Group. He will not receive a bonus as he did not have two months' consecutive service in 2017. This is in line with the bonus scheme rules.

3 Fixed pay includes pension allowance, taxable benefits and any location allowance.

In 2018 base salary, fixed pay and bonus earning opportunity will continue to operate in the same way.

Remuneration policy in practice

The Group's Directors' Remuneration Policy is aligned to our current strategic priorities. The policy supports the Group in delivering its strategy by enabling the Group to recruit and retain talent, to focus on our members and customers, to manage a sustainable business and by complying with the appropriate regulations. The remuneration policy is reviewed regularly to ensure it continues to support the delivery of business strategy.

The Group's approach to remuneration recognises the contribution that Executive Directors make to the success of the organisation. A key principle in developing the Group's remuneration policy is to focus the executive directors on the delivery of key business and customer outcomes. Executive Directors are not involved in deciding their own remuneration.

The remuneration policy was approved by members at the 2016 AGM and remains in force for 2018. A summary of the remuneration policy is set out below. The approved directors' remuneration policy is in the 2015 Annual Report and Accounts, available at ybs.co.uk A summary of the Group's wider remuneration principles and policy is available at ybs.co.uk/pdf/financial/reward-policy.pdf

Executive Director remuneration

	Purpose and link to strategy	Operation	Opportunity
Base pay	Reflects the contribution of executive directors in their role as defined by the combination of: ■ Skills, knowledge and experience; ■ Performance; ■ Demonstrating the Group's behaviours and values.	Base pay is typically reviewed annually in line with the range of increases for all colleagues, and determined with reference to: ■ Role, experience and individual performance; ■ Affordability – the economic environment and overall financial state of the Group; ■ Comparison to the external market, supported by reference to the Group's grading structure, the Career Framework.	n/a
Bonus ('Your Bonus')	Rewards annual performance against financial and customer measures as well as key individual objectives.	■ Key measures within the Corporate Plan have to be achieved for 'on target' pay-out, and considerably exceeded for maximum pay out. ■ The profit figures utilised for pay out may be adjusted at the discretion of the Remuneration Committee in line with approved principles to ensure a true and fair view of performance is applied. ■ Bonuses for Executive Directors will be subject to the relevant disclosures. ■ The Committee reserve the right to apply a malus adjustment (reduce bonus or lapse deferred elements) and to apply clawback (recover bonus payments already made) as applicable. ■ Awards are subject to clawback for up to a maximum of 10 years.	All colleagues participate in the same scheme. ■ 'On-target' achievement of Group performance criteria results in a bonus of 30% of base salary for the Executive Directors. The maximum bonus available to Executive Directors is 50% of base salary.

Directors' Remuneration Report continued...

	Purpose and link to strategy	Operation	Opportunity
Benefits	Executive Directors receive benefits to ensure their total package is in line with market practice to enable the attraction and retention of executive directors of the required calibre.	Benefits include car benefits, healthcare, private medical insurance, life cover and insured sick pay.	All benefits are provided in line with the Group's grading structure, the Career Framework.
Pension	The Group's pension arrangements support the recruitment and retention of executive directors through the provision of competitive retirement benefits.	Executive Directors are eligible to participate in the Group's defined contribution pension scheme. Where contributions exceed the annual or lifetime allowance, Executive Directors may be permitted to take a cash supplement instead of contributions to the plan.	Executive Directors receive a contribution (or cash allowance) equal to a maximum of 16% of base salary.

Approach to new hires and leavers

Provision	Policy
New hires	When agreeing a remuneration package for the appointment of Executive Directors, the Committee will apply the following principles: ▪ The packages will be sufficient to recruit individuals of the required calibre to lead the business and effectively execute the strategy for members. ▪ The Committee will look to align the remuneration package offered with the Group's broader remuneration policy. ▪ The Committee will ensure that the level of pay is necessary but not excessive. ▪ The Committee has discretion within the policy to make remuneration decisions where it considers it appropriate to do so. This ensures that arrangements are in the best interests of both the Group and its members without paying in excess of what is necessary to recruit an executive director of the required calibre.
Notice period	The standard notice period is 12 months from the Group and 12 months from the Executive Directors. In normal circumstances, executive directors will be required to work their notice period. In the event executive directors are not required to fulfil their notice period, they will receive a payment in lieu of notice (PILON) based on fixed elements of pay, or they may be placed on garden leave.
Termination payment	Typically, termination payments will consist of basic salary and other contractual benefits for the notice period, the emphasis being to not reward failure.

Provision	Policy
Bonus – leaver provision	On termination of office, the leaver provisions as set out below will apply. These are also outlined in the Group's bonus plan rules: ■ In the event of retirement or redundancy, ill-health or disability, any bonus will be pro-rated to reflect the time served during the performance period. Any deferred payments due remain subject to future performance conditions and are payable at the end of the corresponding performance periods. They are also subject to the Group's risk overlay process, and therefore subject to the Group's malus and clawback provisions. ■ In the case of death, any bonus payments will be pro-rated to reflect the time served during the performance period. Payment of any deferred amounts, including deferred amounts from previous years, is accelerated and payable at the next payment date. ■ Subject to committee discretion, in the event of resignation, any eligibility to participate in the current year's bonus scheme will cease. Leavers under these circumstances will be eligible to receive deferred bonus payments earned in previous years, subject to the Group's risk overlay process. ■ Where deferred awards continue, they remain subject to the Group's risk overlay process, malus and clawback provisions. Under resignation circumstances, the Share Equivalent Instrument (SEI) value will remain at the original allocated amount.

Chairman and Non Executive Director remuneration

	Operation	Opportunity
Chairman fees	Normally reviewed and approved by the Remuneration Committee on an annual basis (the Chairman does not participate in discussing this item, if a member of the Remuneration Committee).	Fee levels take into account time commitment for the role and practice at other organisations of a similar size and complexity.
Non Executive Director fees	Normally reviewed and approved by the Executive Committee and the Chairman on an annual basis. ■ Non executive directors receive a basic fee. ■ An additional supplement is paid for serving on or chairing a Board Committee. ■ Non Executive Directors do not participate in any performance pay or pension arrangement.	

Directors' Remuneration Report continued...

Annual Report on remuneration

Executive Directors' remuneration

The table below shows the remuneration of the Executive Directors of the Group for the years ended 31 December 2017 and 2016. This table is audited information.

		Fixed Remuneration				
		Base Salary	Pension/ Taxable Benefits	Pension Allowance	Total Bonus[4]	Remuneration
		£000	£000	£000	£000	£000
Executive Director						
Year ended 31 December 2017						
Mike Regnier	CEO	550	15	90	275	930
Robin Churchouse[1]	Former CFO	275	8	46	56	385
Alasdair Lenman[2]	New CFO	27	3	4	–	34
Stephen White	COO	407	31	65	204	707
Year ended 31 December 2016						
Mike Regnier	CCO[3]	376	11	61	177	625
Robin Churchouse	CFO	338	12	55	85	490
Stephen White	COO	340	26	53	144	563

1 Robin Churchouse left the Group on 30 September 2017. His payments reflect his service in 2017.

2 Alasdair Lenman joined the Group on 4 December 2017 with a salary of £350,000. His salary will be reviewed in line with all colleagues, including Executive Directors, in May 2018. His payments in 2017 reflect his length of service with the Group. He will not receive a bonus as he did not have two months' consecutive service in 2017; this is in line with the bonus scheme rules.

3 Mike Regnier's role was Chief Customer Officer in 2016. He became CEO on 1 January 2017.

4 The bonus figures illustrated represent the full amount of bonus awarded in respect of 2017 performance year. Mike and Stephen will only receive 20% of this in 2018, with the remainder deferred over seven years. Full details regarding how bonuses are paid are available on pages 79 to 80.

Base salary

Executive Directors' salaries are reviewed each May at the annual pay review. The 2017 awards were in line with those received by the wider colleague group which, for all colleagues, ranged from 0.3% to over 10.0%. Individual increases are based on performance, relative position to market and affordability, with the aim of retaining talent in a challenging environment. Additional pay awards were also made for the wider colleague group to recognise high performance and respond to market movements; this resulted in some awards at circa 10%. As a result, in 2017, the average pay award for all colleagues was 2.5%, including all Executive Directors.

The table below sets out the increases in base pay levels for Executive Directors following the annual pay review in May 2017. The increase from 2016 to 2017 that Mike Regnier received is reflective of his promotion to CEO on 1 January 2017 and he did not receive an increase in the annual pay review in May 2017. The increase for Robin Churchouse includes additional responsibilities he assumed on 1 January 2017 and his salary was not reviewed again in May.

Executive Director	Base Salary at 1 May 2016 £000	Base Salary at 1 May 2017 £000	Increase %
Mike Regnier	387	550	42.12%
Robin Churchouse	341	376	10.26%
Stephen White	400	407	2.75%

Alasdair Lenman joined the Group on 4 December 2017 with a salary of £350,000.

Bonus

The Group's bonus scheme, 'Your Bonus' is anchored to the core business objectives of financial performance, customer experience and risk management. The scheme design is the same for all colleagues, with varying on-target awards for all colleagues and senior managers. Bonus is awarded on successful achievement of financial and customer performance measures, combined with individual performance. A risk overlay process is also carried out to ensure the Group hasn't been exposed to unnecessary risk; this forms part of our 'sustainability review'. 'On-target' achievement of Group performance criteria results in a bonus of 30% of base salary for the Executive Directors. The maximum bonus available to Executive Directors is 50% of base salary. The payment of bonus is subject to the discretion of the Remuneration Committee, and all executive director bonuses are subject to the relevant deferral periods.

Directors' Remuneration Report continued...

1. Financial performance

Under the terms of the Your Bonus scheme, scope is given to make adjustments to the calculation of profit underpinning payment of the scheme. The following principles are applied when identifying potential adjustments:

- Where an unexpected or unplanned item arises that is not part of the core, business-as-usual running of the Group; for example one-off investments or projects that were not included in the plan profit number against which actual performance is judged.
- Adjustments also include removing both positive and negative impacts from non-core actions that do not reflect management of the underlying Group, for example any unplanned profits (or losses) on the sale of property are not included in the profit before tax (PBT) figure used to calculate bonus outturn.

In line with the above, the overall profit before tax figure was adjusted to produce an achieved position of £154m against a reported figure of £166m. This has performed above target and set the bonus earning potential for the financial element.

2. Customer experience

The second performance measure is the customer 'Net Promoter Score' (NPS), which unlocks the bonus award. The NPS measures how likely our members and customers are to recommend us and we obtain this through customer and broker surveys. The results are combined, at a ratio of 50% mortgages and 50% savings, to create the 'combined NPS' for Your Bonus. To pay an 'on-target' bonus, the target NPS for the year was +35. On average in 2017 the NPS was at +41.

Contribution from different NPS surveys to the overall combined Group NPS score for Your Bonus			
Mortgages – 50%		**Savings – 50%**	
Broker feedback: 25%	Mortgage customer feedback: 25%	Savings customer feedback: 45%	Feedback from Shareplans customers: 5%

3. Sustainability review

Payments will be reduced or forfeited if the sustainable level of capital required to support the Group's growth rate is not generated each year. This is done via a scale adjustment measured against a minimum level of Return on Mean Assets (ROMA) for each year based upon the growth achieved. The 2017 ROMA target for the Group was 0.31%. The 2017 performance year ended with a ROMA position of 0.31%, which was within the desired parameters.

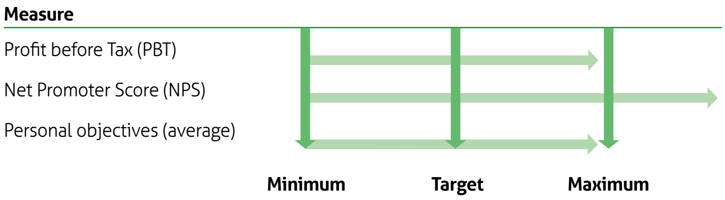
As part of this review, the risk overlay process considers the management of specific business risk appetite measures and payment can be amended where material breaches are identified. Following a rigorous review where business controls processes were assessed, it was deemed that no action was required to adjust the bonus outturn for the 2017 performance year.

4. Individual performance

The Group's performance determines the core bonus award; all three above elements need to be achieved before any bonus will be awarded. Individual performance concludes the percentage of bonus to be awarded.

How bonus is calculated for Executive Directors

The table below summarises the outcome against the various measures for 'Your Bonus'.



How bonus is awarded for our Executive Directors

Executive Director	Role	Award % of salary	Award £000
Mike Regnier	Chief Executive Officer	50	275
Robin Churchouse	Chief Finance Officer	20	56
Stephen White	Chief Operating Officer	50	204

For 2017 performance year, 97.6% of eligible colleagues will receive a bonus. On average an eligible Executive Director achieved 80.0% of their maximum opportunity, with all eligible colleagues on average receiving 66.4% of their maximum opportunity.

Bonuses for Executive Directors remain subject to malus and clawback, with bonus subject to clawback for up to 10 years.

Bonus deferral and Share Equivalent Instrument (SEI)

In line with the PRA and FCA remuneration regulation and the Senior Managers and Certification Regime, all bonuses payable to executive directors designated as 'Senior Managers' are subject to deferral. In addition to regulatory requirements, the Group's remuneration policy requires bonuses for all members of the senior management team are subject to an element of deferral. Bonus deferral ensures that the Group delivers variable pay in a manner that prevents undue risk taking whilst achieving a level of sustainable performance.

For Executive Directors whose remuneration is over the 'de-minimis'* limit, bonus awards are required to have a longer deferral period and/or a larger percentage deferred in line with regulations. Where also required by regulation, 50% of each bonus payment will be delivered via a share equivalent instrument (SEI) and is subject to a retention period. For 2017 performance year, an Executive Director whose remuneration exceeds the de-minimis limit will receive 40% in 2018 with the remaining 60% deferred over seven years, with a one year retention period applying to the SEIs received.

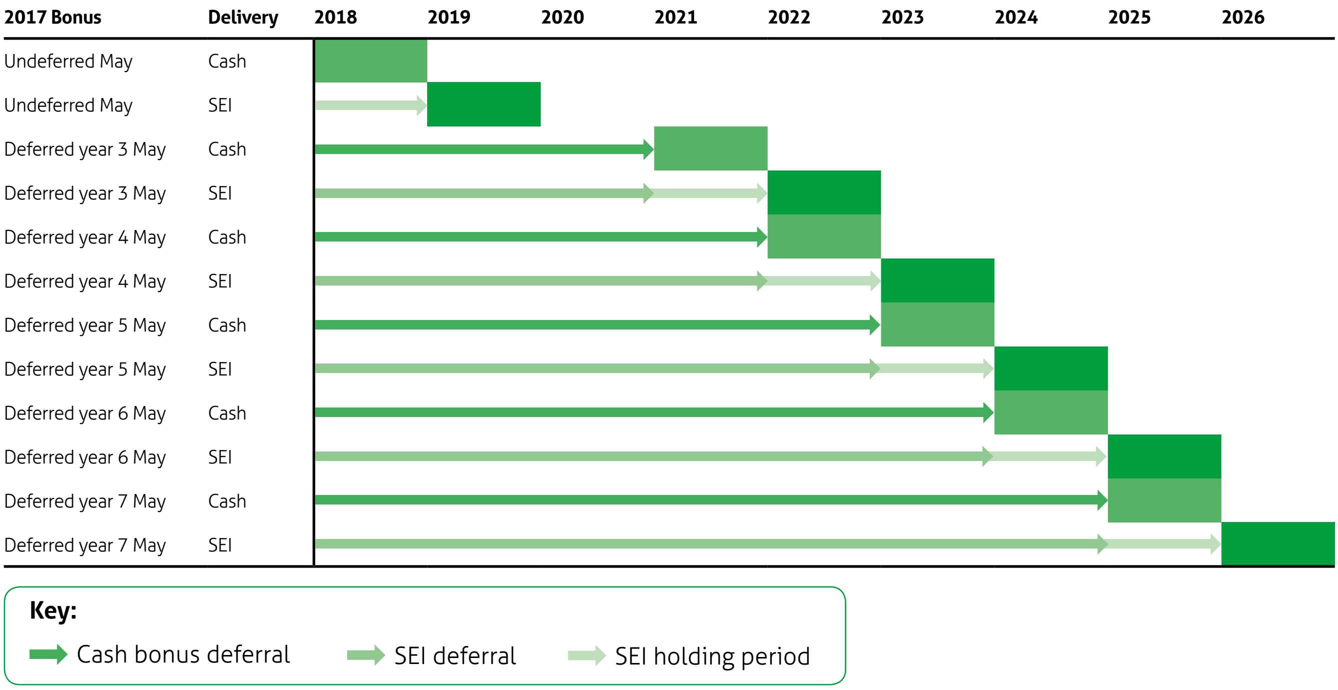
(*A de-minimis limit level is set by regulation, in relation to the level of bonus deferral applied, and impacts colleagues whose total remuneration is greater than £500,000 per annum and/or where variable remuneration is more than 33% of their total remuneration.)

For example:

- Year 1 – 40% of any bonus earned is paid out in the year following the performance year. Half of this amount is paid in cash and the other half is delivered in a SEI and subject to an additional retention period prior to revaluation and payment.
- Deferral years – the remaining 60% is deferred for seven years and paid equally each year from three years after the award. Each year, the award is split in two, with half the amount paid in cash and the second half held in a SEI and subject to an additional retention period prior to revaluation and payment. SEI valuations continue every 12 months until the bonus schedule is complete.

Directors' Remuneration Report continued...

Length of time variable pay is at risk



For Executive Directors whose total remuneration is below the de-minimis limit, annual bonus awards will be delivered as cash and paid over three years: 50% of any bonus is paid out in the year following the performance year; the remaining 50% is deferred with 25% released after one year and 25% released after two years.

How did bonus deferral work for our Executive Directors?

	Total bonus £000	% Deferred	Deferral period	SEI
Mike Regnier	275	60	7 years	Y
Robin Churchouse	56	50	2 years	N
Alasdair Lenman	–	n/a	n/a	n/a
Stephen White	204	60	7 years	Y

Taxable benefits

The taxable benefits awarded to executive directors are in line with the wider colleague offering, comprising a company car (or equivalent allowance), private medical insurance, permanent health insurance and any location allowances. Executive Directors, like all colleagues, can also participate in a concessionary mortgage scheme which is subject to a maximum concessionary amount of £160,000; no executive directors have taken up this mortgage scheme. No significant changes to the construct of the Executive Directors' benefits entitlement are planned for 2018.

Pensions

From 1 January 2017 all executive directors are members of the Group's defined contribution scheme; a core contribution of up to 16% of base salary is paid for this population. Where prevailing tax restrictions limit pension contributions, the remainder is paid as a cash allowance.

The pension scheme also provides a lump sum of six times pensionable salary on death in service.

Movement in CEO remuneration relative to the wider colleague population

As noted earlier in the report, Mike Regnier received a pay increase on 1 January 2017 when he assumed the role of CEO. His pay was not reviewed in line with the wider colleague population in May. He received no further increase to pay in 2017. The average pay increase for all colleagues (including executive directors) was 2.5%.

Due to the out-going CEO's leaving arrangements, there was no bonus paid to the former CEO in 2016 therefore no comparison can to be made to 2017. In 2017, the average bonus awarded to colleagues was 13.4% higher than in 2016.

Payment for loss of office

Robin Churchouse stepped down from the Board on 30 September 2017. All payments made to him in respect of his service during 2017 are reported in the single figure of remuneration table above. Robin is contracted to a 12 month notice period but will not work the remainder of his notice. He will receive the payment of his total notice period as payment in lieu of notice (PILON) in monthly instalments, ending in September 2018. PILON payments are made up of base salary and benefits only. This payment is subject to mitigating provisions. The Committee, at its discretion, has awarded Robin a bonus of 20% of salary under the 2017 Your Bonus scheme in relation to the period worked in 2017. This is an exercise of the Committee's discretion under the 'bonus – leaver provisions' section of the remuneration policy.

In line with the remuneration policy and the bonus scheme rules, the Committee considered it appropriate to allow the deferred portions of Robin's outstanding variable pay awards to continue in full. These payments will be subject to continued performance adjustment requirements and payments will be made on the normal due dates. Regulatory requirements relating to risk adjustments, malus and clawback will continue to apply to all deferred bonus awards in the same way as if Robin had remained in employment.

The Group paid £1,080 to Robin towards the cost of independent legal advice regarding the cessation of his employment.

All payments made in respect of Robin's leaving arrangements are in line with the Executive Directors' Remuneration Policy.

Chairman and Non Executive Directors

In line with the annual review of Chairman and Non Executive Director fees, the fee levels were reviewed in June 2017 and came into effect on 1 July 2017. Non Executive Directors' basic fees were increased by 2.1% in July 2017. This change took into account external market data, the skills and the time commitment required for the role as well as wider colleague salary increases. This change was recommended to reflect comparable market data and nearest peer comparators.

Non Executive Director fees (annual equivalents)	Fees at 1st July 2016 £000	Fees at 1st July 2017 £000	Uplift %
Chairman's basic fees	184.7	188.6	2.1
Vice Chairman basic fees	69.0	70.5	2.1
Non Executive Director basic fees	48.5	49.5	2.1
Additional fee for:			
Audit Committee – Chair	20.1	20.5	2.1
Audit Committee – Member	8.3	8.5	2.1
Remuneration Committee – Chair	16.4	16.7	2.1
Remuneration Committee – Member	6.0	6.1	2.1
Group Risk Committee – Chair	20.1	20.5	2.1
Group Risk Committee – Member	8.3	8.5	2.1

Directors' Remuneration Report continued...

Single total figure of remuneration for each Non Executive Director

The Non Executive Directors' basic and committee fees earned in 2017 are outlined below. Note that the Group's Non Executive Directors do not receive any benefits. Non Executive Directors are reimbursed for any expenses incurred, such as travel and subsistence. Any tax due is the responsibility of individual non executive directors.

Non Executive Director	2016 Basic Fees £000	2016 Committee Fees £000	Total £000	2017 Basic Fees £000	2017 Committee Fees £000	Total £000
John Heaps (Chairman)	182	–	182	187	–	187
Neeta Atkar[1]	–	–	–	33	20	53
Dame Kate Barker[2]	48	14	62	15	5	20
Alison Hutchinson	48	14	62	49	14	63
Gordon Ireland	48	8	56	49	14	63
David Paige[2]	48	29	77	15	9	24
Mark Pain (Vice Chairman)	69	28	97	70	28	98
Guy Parsons	48	16	64	49	17	66

1 Neeta Atkar became a Non Executive Director on 25 April 2017.

2 Dame Kate Barker and David Paige stepped down from the Board on 25 April 2017.

Remuneration Committee terms of reference

The Remuneration Committee has specific responsibility for ensuring we have the right policies in place for our most senior roles and setting the tone for the wider organisation. Its purpose is to oversee the remuneration policy in place for YBS Group, making sure it aligns to the Group's business strategy and any regulatory compliance requirements, with a specific focus on the risks posed by remuneration policies and practices. This includes approving the design of, and determining the performance targets for, any discretionary performance pay plans operated by the Group.

The Committee's terms of reference were reviewed and updated in November 2017. The full terms of reference are available on the Group's website ybs.co.uk/committees

The members of the Remuneration Committee consist of independent Non Executive Directors and include a member of the Group's Risk Committee. During the year the Committee members were Guy Parsons (Chair of the Remuneration Committee), John Heaps and Alison Hutchinson.

The Committee met seven times during the year and covered the following activities:

- A strategic review of the Group's reward strategy
- Agreeing the Group's bonus scheme 'Your Bonus' structure and targets
- Ongoing work in relation to the Prudential Regulatory Authority's (PRA) Remuneration Code and how it applies to the Group
- Agreeing the approach for executive base salary increases in 2017
- Agreeing the remuneration package for the new Chief Officers
- Agreeing the compensation arrangements for the out-going Chief Finance Officer.

The Committee is supported by the Chief People Officer, the Director of People Performance and, where appropriate, the Chief Executive Officer is invited to attend to provide further background and context to assist the Committee in discharging its duties.

The Remuneration Committee draws on the advice of independent external consultants to support in performing its duties. During the year, the Committee sought advice on executive director salaries, variable pay structures and regulatory matters from PwC. The committee is satisfied that the advice received is objective and independent. PwC's fees for advice provided to the Committee in 2017 were £113,400 (including irrecoverable VAT); £99,900 in 2016 (including irrecoverable VAT). During 2017, PwC also provided business consulting services across the Group on matters including IT risk assurance, data assurance, project assurance, operational risk assurance, regulatory compliance monitoring services, internal audit, risk treasury (hedge accounting) support, accounting advisory support and tax advisory support.

Statement of member voting

The Group remains committed to ongoing member dialogue and takes an active interest in voting outcomes. The following table sets out actual voting in respect of the resolution to approve the 2017 Directors' Remuneration Report at the Group's Annual General Meeting (AGM) in 2017.

Resolution	Votes for	Votes against	% in favour	Votes withheld
To approve the Directors' Remuneration Report	128,159	14,760	89.67	3,240

As noted in the Committee Chairman's letter, there will be an advisory vote on the Annual Report on Remuneration at the 2018 AGM.

On behalf of the Board

Guy Parsons
Chairman of the Remuneration Committee
28 February 2018

Directors' Remuneration Report continued...

Aggregate remuneration data

In accordance with the Capital Requirements Regulation as part of CRD IV, which requires the disclosure of the aggregate remuneration data for senior managers and MRTs, the Group's data is set out as follows:

	Senior Management[1] £000	Other MRTs £000	Total £000
Aggregate remuneration data			
Fixed Pay	8,370	896	9,266
2017 Variable pay (undeferred)	1,370	77	1,447
2017 Variable pay (deferred)	1,497	–	1,497
2017 Variable pay due via SEI	318	–	318
Deferred variable pay to be paid 2018	1,106	–	1,106
Outstanding deferred variable pay from previous years	892	–	892
Total	13,235	973	14,208
Aggregate bonus buyout and severance payments			
Bonus buyout payments – 2017	134	–	134
Severance payments – 2017	415	–	415
Total	549	–	549

	Senior Management	Other MRT	Total
Number of MRT colleagues at 1.1.17	44	9	53
Number of MRT colleagues at 31.12.17	27	8	35

[1] Senior managers and colleagues whose actions have a material impact on the risk profile (including Executive and Non Executive Directors). Non Executive Directors' fees are included under fixed pay. No variable pay was awarded to Non Executive Directors.

Ratios between fixed and variable pay

YBS Group's fixed:variable pay ratio is not affected by the CRD IV cap on variable pay as the variable component of total remuneration to the fixed component does not exceed 1:1. The maximum annual bonus award for any colleague is 50% of base salary and therefore variable pay will not exceed the CRD IV cap.

Independent Auditor's Report
to the members of Yorkshire Building Society

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

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

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

- the Group and Society Income Statements;
- the Group and Society Statements of Comprehensive Income;
- the Group and Society Statements of Financial Position;
- the Group and Society Statements of Changes in Members' Interest;
- the Group and Society Statements of Cash Flows;
- the related notes 1 to 43.

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Group and the Society in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group and 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: ■ Fair value adjustments ■ Loan loss provisions ■ Hedge accounting and derivatives ■ Provision for Mortgage Payment Protection Insurance policies ("MPPI") redress
Materiality	The materiality that we used in the Group financial statements was £8.0m which was determined on the basis of 5% profit before tax as per the Consolidated Income Statement.
Scoping	As in the prior year, our Group audit scope involved performing full audits on the Group's parent and main subsidiaries which accounted for more than 98% of the Group's net assets and 99% of the Group's profit before tax. These audits were performed directly by the Group audit team and executed to each of the individual entity materialities which were lower than the Group materiality and ranged from £2.7m to £4.8m.
Significant changes in our approach	The key audit matters are consistent with those identified in the prior year, with the exception of: ■ the removal of the effective interest rate adjustment relating to revenue recognition because our risk assessment of the judgements applied by the Group shows that they are not materially sensitive; ■ the removal of the valuation of defined benefit pension assets because the derivative investments held in the defined benefit pension scheme are not complex to value; and ■ the addition of PPI provisions because the increase in complaints received by the Group in the year beyond original projections, influenced by legislative announcements, has made management's judgements in forecasting future complaints materially sensitive.

Independent Auditor's Report
to the members of Yorkshire Building Society continued...

Conclusions relating to going concern, principal risks and viability statement

Going concern

We have reviewed the directors' statement in note 1 to the financial statements about whether they considered it appropriate to adopt the going concern basis of accounting in preparing them and their identification of any material uncertainties to the Group's and Society's ability to continue to do so over a period of at least 12 months from the date of approval of the financial statements.

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

Principal risks and viability statement

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

- the disclosures on pages 61 to 69 that describe the principal risks and explain how they are being managed or mitigated;
- the directors' confirmation on page 37 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; or

  the directors' explanation on page 37 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.

Fair value adjustments

Key audit matter description	The Group's assessment of the utilisation of the fair value adjustments that were established upon the merger of the Society with Norwich & Peterborough Building Society (N&P) and Chelsea Building Society (CBS) in prior years is an area that requires the use of significant judgement. The primary judgement relates to the level of lifetime losses that are expected from the acquired loan books, in particular the level of capital that will be recoverable from the CBS interest-only portfolio. The future expected losses are compared with those anticipated at the dates of the mergers with any reduction in the required provision being reflected in the effective interest rate and any additional provision required reflected as an incurred loss impairment where appropriate. There is a risk of fraud inherent in the application of fair value adjustments given the material impact and sensitivity of these judgements on the final figure and therefore profit for the year. The Group's associated accounting policies are detailed on page 104, with detail about judgements in applying accounting policies and critical accounting estimates on page 106. This key audit matter was discussed by the Audit Committee as detailed in the Audit Committee Report on page 58.

How the scope of our audit responded to the key audit matter	We understood Management's fair value adjustments process by undertaking a walk-through to identify the key controls, data flows and input sensitivities. We assessed the design and implementation of the governance review control in respect of key judgements over model inputs. We identified the most significant judgements made by the Group in the calculation as being the estimation of future property values, the estimation of customers that will remain on an interest- only product until the term of the loan, and the probability of interest-only customers having a repayment vehicle on maturity of their loan. We benchmarked the key assumptions against internal, external and industry data where available, and calculated an independent range of values. Our acceptable range for the fair value estimate was determined by using reasonably plausible alternative assumptions, in particular around the house price forecasts and the interpretation of responses to a customer contact programme relating to the availability of a repayment vehicle at the maturity of interest-only accounts, as well as publicly available data about interest-only customers across the mortgage market. We tested the mechanical accuracy of the related models, engaging our IT and data specialists to independently recalculate the expected lifetime losses from data that was tested for accuracy and completeness.
Key observations	We found that the fair value adjustments were materially correct.

Independent Auditor's Report

to the members of Yorkshire Building Society continued...

Loan loss provisions

Key audit matter description	The Group holds £32.5m of impairment provisions at year-end (2016: £45.0m) against total loans and advances to customers of £35.1bn (2016: £34.1bn). Determining impairment provisions against loans to customers is a judgemental area requiring an estimate to be made of the losses incurred within the residential mortgage, buy to let and commercial lending portfolios. This requires the formulation of assumptions relating to potential impairment indicators, customer default rates, property values and movements, and likelihood of repossession, all of which may be sensitive to changes in the economic environment. There is a risk that arrears-driven loan loss provision models do not capture all values of impairment in the portfolios and where this is the case the Group may use overlay models to quantify the additional provision required. The Group identified a population of over-indebted customers in the loan portfolio that has not met the formal impairment trigger established by the Group but which is felt to include a material level of incurred but not report loss. The Group designed a separate model to quantify an appropriate provision. There is a risk of fraud inherent in the application of loan loss provisioning given the material impact of management judgements on the final figure and therefore the profit for the year. Loan loss provision balances are detailed within notes 16 and 39. Management's associated accounting policies are detailed on page 103 with detail about judgements in applying accounting policies and critical accounting estimates on page 106. This key audit matter was discussed by the Audit Committee as detailed in the Audit Committee Report on page 58.
How the scope of our audit responded to the key audit matter	We understood the Group's loan loss provisioning process by undertaking a walk-through to identify the key controls, data flows and input sensitivities. We assessed the design and implementation and tested the operating effectiveness of controls on the lending cycle used to derive the data used for the loan loss provision model. We also assessed the design and implementation of the governance review of key judgements over inputs to the model. Our risk assessment identified the most significant judgements, which included house price forecasts, probability of possession and the level of impairment relating to over-indebted customers. We also assessed the completeness of the Group's consideration of potential impairment indicators as impairment trigger events for overlay provisions. We benchmarked significant judgements and model outputs including the Group's use of overlays against internal and external data calculating an independent range of expected provision levels. Our range was determined by using reasonably plausible alternatives, in particular around the probability of possession rate and house price forecast, using alternative historical averages and forward-looking information taking into consideration the uncertainty in the current economic and political environment and the impact this could have on the housing market and specific populations within the Group's portfolio. We also tested the accuracy and completeness of the core provision calculation and overlay models through independently re-performing Management's provision calculation engaging our IT and data specialists. For commercial loans, we performed detailed file reviews of a sample of properties across the book, including identifying any impairment indicators using our own risk assessment tool and assessing whether these had been properly reflected within provision calculations by the Group. We tested the valuation of the underlying property collateral using our property valuation specialists.
Key observations	We found that the impairment model assumptions were determined and applied consistently and appropriately with mechanical calculations used to quantify overlay provisions.

Hedge accounting and derivatives

Key audit matter description	The Group holds derivative financial instruments in order to mitigate the risks associated primarily with interest rate and basis risk, and eliminating where possible certain foreign currency exposures. The Group designates such derivatives into hedging relationships to reduce income statement volatility; the hedging relationships designated to reduce volatility relating to the foreign currency exposures involve more complexity because of the nature of the swaps used and varying methodologies used to measure effectiveness. The net fair value of the cross currency derivatives at year-end totals £420.3m asset (2016: £343.9m asset) as disclosed in the notes to the financial statements on page 143. The hedge accounting requirements are complex and require significant skilled input and oversight by Management, as well as robust systems and controls. The Group's associated accounting policies are detailed on page 103 and were discussed by the Audit Committee as detailed in the Audit Committee Report on page 58.
How the scope of our audit responded to the key audit matter	We performed a walk-through of the Group's treasury and hedge accounting processes to understand Management's process for trading in derivatives and the data flows that underpin and inform hedge accounting and valuation decisions. Once we had identified the key controls we performed an assessment of the design and implementation of such controls. We tested the Group's application of hedge accounting which comprised testing hedge documentation for compliance with the requirements of the accounting standards, and independently re-performing a sample of hedge effectiveness tests conducted by Management during the year. We independently calculated the fair value of a sample of the cross currency swaps and the underlying hedged items.
Key observations	We agree that the implementation of hedge accounting requirements and specifically the designation of cross currency derivatives into hedge relationships and the assessment of the effectiveness of hedge relationships are appropriate and in line with supporting documentation. We identified a valuation error that is below materiality relating to the underlying hedged items that if corrected would increase net assets. We also identified a classification error between Debt Securities in Issue, Loans and advances to customers and Interest in associated undertakings of the Society's Balance Sheet. We concluded that in the circumstances of the Society, and of the Group, the treatment of valuation of these balances was appropriate.

Independent Auditor's Report

to the members of Yorkshire Building Society continued...

Provision for Mortgage Payment Protection Insurance policies ("MPPI") redress

Key audit matter description	Significant provisions have been made to reflect customer redress payments relating to the past sales of MPPI. Given the number and volume of the policies sold by the Group historically and the continued public focus on the industry in relation to miss-selling of such policies there is a risk that the Group's provisions are incomplete and do not adequately provide for expected future claims. There is also a risk that there is inadequate disclosure about the related provision. The provision at the year-end totalled £21.3m (2016: £9.6m) as disclosed in the notes to the financial statements on pages 136 to 137. The Group's associated accounting policies are detailed on page 105 with detail about judgements in applying accounting policies and critical accounting estimates on page 107. This key audit matter was discussed by the Audit Committee as detailed in the Audit Committee Report on page 58.
How the scope of our audit responded to the key audit matter	We understood management's process for calculating the potential exposure and estimated cost of future customer claims including identification of key controls, data flows and input sensitivities. Once we had identified the key controls we performed an assessment of the design and implementation of such controls. We re-performed management's provision calculation and also tested the underlying data used in the calculation for completeness and accuracy. To challenge the Group's estimate we calculated an independent range using historical data and future expectations using our understanding of the sector and benchmarked to other organisations. We have reviewed the disclosures in Note 28 for compliance with IAS 37 Provisions, contingent liabilities and contingent assets.
Key observations	We are satisfied that the basis for the Group's calculation is reasonable and uses all available data to calculate a best estimate. Based on the results of our independent range analysis we believe that the Group's provision is towards the conservative end of a reasonable range.

Our application of materiality

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

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

	Group financial statements	Society financial statements
Materiality	£8.0m (2016: £7.1m)	£4.7m (2016: £5.2m)
Basis for determining materiality	Below 5% of profit before tax (2016: below 5% of profit before tax adjusted for fair value volatility). In 2016, the Group experienced significant fair value volatility throughout the year following the UK's decision to leave the EU in June 2016. To enable a stable materiality level to be used we adjusted for such volatility from the Group's profit before tax in our determination of materiality. In 2017, the Group's fair value volatility has been consistent throughout the year therefore we have based our materiality profit before tax.	Below 5% of profit before tax (2016: below 5% of profit before tax adjusted for fair value volatility). In 2016, the Society experienced significant fair value volatility throughout the year following the UK's decision to leave the EU in June 2016. To enable a stable materiality level to be used we adjusted for such volatility from the Society's profit before tax in our determination of materiality. In 2017 the Society's fair value volatility has been consistent throughout the year therefore we have based our materiality on 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. This was a key factor in why we determined that profit before tax was the most appropriate benchmark for determining materiality, consistent with the prior year.	The accumulation of profits is critical to maintaining and building capital for regulatory purposes and allowing the Society to invest in activities for its members. This was a key factor in why we determined that profit before tax was the most appropriate benchmark for determining materiality, consistent with the prior year.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £190,000 (2016: £150,000) for the Group and the Society, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

As in the prior year, our Group audit scope involved performing full audits on the Society and main subsidiaries which accounted for more than 99% (2016: 98%) of the Group's net assets and 99% (2016: 99%) of the Group's profit before tax. These audits, including audit of the Society, were performed directly by the Group audit team and executed to each of the individual entity which were lower than the Group materiality and ranged from £2.7m to £4.8m (2016: £4.3m to £5.6m).

At the parent entity level we also tested the consolidation proves and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement in the aggregated financial information of the remaining components not subject to audit.

Independent Auditor's Report

to the members of Yorkshire Building Society continued...

Other information

The directors are responsible for the other information. The other information comprises the information included in the Annual Report including the Chairman's Statement, the Chief Executive Officer's Review, the Strategic Report, the Corporate Responsibility Report, the Risk Management Report, the Directors' Report, the Corporate Governance Report, the Audit Committee Report and the Directors' Remuneration Report, other than the financial statements and our auditor's report thereon.

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

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

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

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

Fair, balanced and understandable – the statement given by the directors that they consider the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy, is materially inconsistent with our knowledge obtained in the audit; or

Audit Committee reporting – the section describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have nothing to report in respect of these matters.

Responsibilities of directors

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

In preparing the financial statements, the directors are responsible for assessing the Group's and the Society's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the Society or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

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

Use of our report

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

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Building Societies Act 1986

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

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

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

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

In our opinion the information given on page 43 for the financial year ended 31 December 2017 has been properly prepared, in all material respects, in accordance with the Capital Requirements (Country-by-Country Reporting) Regulations 2013.

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 22 July 2009 to audit the financial statements for the year ending 31 December 2009 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is nine years, covering the years ending 31 December 2009 to 31 December 2017.

Consistency of the audit report with the additional report to the audit committee

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

Peter Birch FCA
(Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Leeds
28 February 2018

Income Statements
for the year ended 31 December 2017

		Group		Society	
	Notes	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Interest receivable and similar income	3	**1,078.2**	1,178.8	**987.0**	1,102.5
Interest payable and similar charges	4	**(576.1)**	(703.2)	**(642.1)**	(765.7)
Net interest income		**502.1**	475.6	**344.9**	336.8
Fees and commissions receivable		**30.7**	32.3	**20.2**	23.5
Fees and commissions payable		**(24.2)**	(23.4)	**(15.5)**	(16.2)
Net fee and commission income		**6.5**	8.9	**4.7**	7.3
Income from investments	10	**3.2**	12.2	**59.9**	62.2
Net gains/(losses) from fair value volatility on financial instruments	5	**13.1**	0.9	**14.4**	(12.7)
Net realised profits	6	**6.1**	1.8	**6.1**	1.8
Other operating income	1	**4.8**	15.2	**53.4**	63.8
Total income		**535.8**	514.6	**483.4**	459.2
Administrative expenses	7	**(308.1)**	(323.3)	**(308.1)**	(323.1)
Depreciation and amortisation		**(31.4)**	(22.7)	**(31.4)**	(22.7)
Operating profit before provisions		**196.3**	168.6	**143.9**	113.4
Impairment releases/(charge) on loans and advances to customers	9	**9.8**	(0.1)	**3.9**	1.4
Provisions for liabilities and charges	28	**(40.3)**	(17.0)	**(40.2)**	(17.0)
Impairment charge on investments in subsidiaries	10	**–**	–	**–**	(0.3)
Operating profit and profit before tax		**165.8**	151.5	**107.6**	97.5
Tax expense	11	**(41.4)**	(37.3)	**(23.9)**	(19.0)
Net profit		**124.4**	114.2	**83.7**	78.5

Net profit arises from continuing operations and is attributable to members.

The notes on pages 100 to 176 form part of these accounts.

Statements of Comprehensive Income
for the year ended 31 December 2017

	Notes	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Net profit		**124.4**	114.2	**83.7**	78.5
Items that may subsequently be reclassified to profit and loss:					
Available for sale investments:					
Valuation gains taken to equity		**11.6**	9.0	**11.6**	9.0
Amounts transferred to Income Statement (included in net realised profits)	42	**(8.0)**	(0.7)	**(8.0)**	(0.7)
Tax on available for sale securities	11	**(1.0)**	(2.3)	**(1.0)**	(2.3)
Effect of change in corporation tax rate	11	**0.1**	0.3	**0.1**	0.3
Cash flow hedges:					
Gains/(losses) taken to equity		**2.2**	(25.7)	**2.2**	(25.7)
Amounts transferred to Income Statement (included in net realised profits)	42	**3.8**	46.0	**3.8**	46.0
Tax on cash flow hedge reserve	11	**(1.6)**	(5.7)	**(1.6)**	(5.7)
Effect of change in corporation tax rate	11	**0.1**	0.3	**0.1**	0.3
Subtotal		**7.2**	21.2	**7.2**	21.2
Items that will not be reclassified subsequently to profit and loss:					
Re-measurement of net retirement benefit obligations	26	**49.6**	(27.0)	**49.6**	(27.0)
Tax relating to retirement benefit obligations	11	**(13.5)**	7.6	**(13.5)**	7.6
Effect of change in corporation tax rate	11	**1.2**	–	**1.2**	–
Subtotal		**37.3**	(19.4)	**37.3**	(19.4)
Total comprehensive income for the year		**168.9**	116.0	**128.2**	80.3

The notes on pages 100 to 176 form part of these accounts.

Statements of Financial Position
as at 31 December 2017

		Group		Society	
	Notes	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Assets					
Liquid assets					
Cash in hand and balances with the Bank of England	13	**4,893.9**	3,525.0	**4,893.9**	3,525.0
Loans and advances to credit institutions	14	**351.0**	542.8	**126.6**	257.2
Debt securities	15	**850.8**	608.1	**5,976.2**	5,226.0
Loans and advances to customers	16	**35,061.2**	34,103.3	**16,337.3**	17,604.1
Derivative financial instruments	34	**591.8**	540.5	**324.1**	303.4
Investments	10	**6.3**	10.3	**21,105.4**	17,964.5
Intangible assets	17	**32.2**	34.1	**32.2**	34.1
Investment properties	18	**12.4**	15.0	**12.2**	14.8
Property, plant and equipment	19	**113.3**	129.3	**112.8**	128.9
Current tax assets		**–**	–	**–**	9.6
Deferred tax assets	20	**8.7**	16.3	**7.3**	12.3
Retirement benefit surplus	26	**95.2**	42.0	**95.2**	42.0
Other assets	21	**30.4**	28.8	**39.7**	39.6
Total assets		**42,047.2**	39,595.5	**49,062.9**	45,161.5
Liabilities					
Shares	22	**28,938.0**	28,693.2	**28,938.0**	28,693.2
Amounts owed to credit institutions	23	**4,451.6**	3,120.8	**4,442.9**	3,111.4
Other deposits	24	**420.2**	434.7	**8,468.2**	6,898.8
Debt securities in issue	25	**4,933.3**	4,361.4	**4,192.1**	3,706.8
Derivative financial instruments	34	**156.9**	348.0	**160.0**	351.8
Current tax liabilities		**19.4**	12.8	**4.6**	–
Deferred tax liabilities	20	**29.6**	16.2	**29.2**	15.8
Other liabilities	27	**62.5**	54.7	**55.9**	53.0
Provisions	28	**45.8**	29.1	**45.7**	29.0
Subordinated liabilities	29	**593.7**	297.0	**593.7**	297.0
Subscribed capital	30	**6.4**	6.7	**6.4**	6.7
Total liabilities		**39,657.4**	37,374.6	**46,936.7**	43,163.5
Total equity attributable to members		**2,389.8**	2,220.9	**2,126.2**	1,998.0
Total equity and liabilities		**42,047.2**	39,595.5	**49,062.9**	45,161.5

The accounts on pages 94 to 176 were approved by the Board of directors on 28 February 2018 and were signed on its behalf by:

John Heaps — Chairman
Mark Pain — Vice Chairman
Mike Regnier — Chief Executive

The notes on pages 100 to 176 form part of these accounts.

Statements of Changes in Members' Interest
for the year ended 31 December 2017

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Group				
At 1 January 2017	**2,220.9**	**(8.1)**	**8.1**	**2,220.9**
Current year movement net of tax	**161.7**	**4.5**	**2.7**	**168.9**
At 31 December 2017	**2,382.6**	**(3.6)**	**10.8**	**2,389.8**
At 1 January 2016	2,123.0	(23.0)	4.9	2,104.9
Reallocation of tax*	3.0	–	(3.0)	–
Current year movement net of tax	94.9	14.9	6.2	116.0
At 31 December 2016	2,220.9	(8.1)	8.1	2,220.9

	General reserve £m	Hedging reserve £m	Available for sale reserve £m	Total reserves £m
Society				
At 1 January 2017	**1,998.0**	**(8.1)**	**8.1**	**1,998.0**
Current year movement net of tax	**121.0**	**4.5**	**2.7**	**128.2**
At 31 December 2017	**2,119.0**	**(3.6)**	**10.8**	**2,126.2**
At 1 January 2016	1,935.8	(23.0)	4.9	1,917.7
Reallocation of tax*	3.0	–	(3.0)	–
Current year movement net of tax	59.2	14.9	6.2	80.3
At 31 December 2016	1,998.0	(8.1)	8.1	1,998.0

*Taxation relating to the Available for sale reserve has been reallocated to match the underlying transactions.

The hedging reserve relates to fair value adjustments on derivative financial instruments designated as cash flow hedges. It is expected that the forecast transactions will largely occur over the next five years and the amount deferred will be recognised over this period.

The notes on pages 100 to 176 form part of these accounts.

Statements of Cash Flows
for the year ended 31 December 2017

		Group		Society	
	Notes	**2017 £m**	2016 £m	**2017 £m**	2016 £m
Cash flows from operating activities:					
Profit before tax		**165.8**	151.5	**107.6**	97.5
Working capital adjustments	43	**51.8**	7.0	**54.6**	6.8
Net increase in operating assets	43	**(1,122.0)**	(766.8)	**(2,018.0)**	(519.2)
Net increase in operating liabilities	43	**1,561.1**	1,005.6	**3,145.7**	1,571.1
Taxation paid		**(28.5)**	(20.7)	**(6.2)**	(9.8)
Net cash flows from operating activities		**628.2**	376.6	**1,283.7**	1,146.4
Cash flows from investing activities:					
Purchase of property, plant and equipment and intangible assets and investment properties		**(18.2)**	(17.8)	**(18.2)**	(17.8)
Proceeds from sale of property, plant and equipment		**9.3**	20.4	**9.3**	20.4
Purchase of debt securities		**(1,031.2)**	(502.4)	**(3,031.3)**	(2,502.4)
Proceeds from sale and redemption of debt securities		**798.2**	173.9	**2,290.6**	1,539.8
Net cash flows used in investing activities		**(241.9)**	(325.9)	**(749.6)**	(960.0)
Cash flows from financing activities:					
Redemption of securities		**(213.4)**	(804.3)	**–**	(500.0)
Issue of securities		**726.7**	700.0	**426.7**	400.0
Redemption of subordinated liabilities		**(5.0)**	–	**(5.0)**	–
Issue of subordinated liabilities		**300.0**	–	**300.0**	–
Interest paid on subordinated liabilities and subscribed capital		**(19.1)**	(16.0)	**(19.1)**	(16.0)
Net cash flows from/(used in) financing activities		**789.2**	(120.3)	**702.6**	(116.0)
Net increase/(decrease) in cash and cash equivalents		**1,175.5**	(69.6)	**1,236.7**	70.4
Opening balance		**4,016.2**	4,085.8	**3,730.6**	3,660.2
Total closing cash and cash equivalents		**5,191.7**	4,016.2	**4,967.3**	3,730.6
Cash and cash equivalents:					
Cash and balances with central banks		**4,840.7**	3,473.4	**4,840.7**	3,473.4
Loans and advances to credit institutions	14	**351.0**	542.8	**126.6**	257.2
		5,191.7	4,016.2	**4,967.3**	3,730.6

Statements of Cash Flows continued...

for the year ended 31 December 2017

The following table reconciles liabilities arising from financing activities

		Cash flows		Non-cash changes caused by:				
	2016 £m	Redemption	Issue	Foreign exchange movement	Accrued interest	Fair value adjustments	Other	2017 £m
Group								
Debt securities in issue	4,361.4	(213.4)	726.7	111.3	2.3	(55.3)	0.3	**4,933.3**
Subordinated liabilities	297.0	(5.0)	300.0	–	3.0	1.0	(2.3)	**593.7**
Subscribed capital	6.7	–	–	–	–	(0.3)	–	**6.4**
Total liabilities from financing activities	**4,665.1**	**(218.4)**	**1,026.7**	**111.3**	**5.3**	**(54.6)**	**(2.0)**	**5,533.4**

		Cash flows		Non-cash changes caused by:				
	2016 £m	Redemption	Issue	Foreign exchange movement	Accrued interest	Fair value adjustments	Other	2017 £m
Society								
Debt securities in issue	3,706.8	–	426.7	111.3	2.0	(55.3)	0.6	**4,192.1**
Subordinated liabilities	297.0	(5.0)	300.0	–	3.0	1.0	(2.3)	**593.7**
Subscribed capital	6.7	–	–	–	–	(0.3)	–	**6.4**
Total liabilities from financing activities	**4,010.5**	**(5.0)**	**726.7**	**111.3**	**5.0**	**(54.6)**	**(1.7)**	**4,792.2**

The Statements of Cash Flows have been prepared in compliance with IAS 7 'Statements of Cash Flows' and have been presented under the indirect method. For the purposes of the Statements of Cash Flows, cash and cash equivalents comprise cash and other financial instruments with original maturities of less than three months.

The notes on pages 100 to 176 form part of these accounts.

Notes to the Accounts

Introduction

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations (IFRICs) in issue, that have been endorsed by the EU, and are effective at 31 December 2017, and 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 financial statements have been prepared on the historical cost basis, as modified by the revaluation of certain financial instruments measured at fair value at the end of each reporting period.

The financial statements have been prepared on the going concern basis as discussed in the Strategic Report on page 37, under the heading, 'viability and going concern'.

The preparation of financial statements under IFRS requires the use of certain critical accounting estimates and judgement. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are set out in Note 2.

Accounting developments – IFRS 9

IFRS 9 'Financial Instruments' was published in July 2014 and is effective for periods beginning on or after 1 January 2018. This replaces IAS 39 'Financial Instruments: Recognition and Measurement', and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting. Further details of the changes and impact on the Group are described later in this section.

Classification and measurement
Financial assets will be classified as amortised cost, fair value through other comprehensive income, or fair value through profit or loss, depending on the entity's business model and the contractual cash flow characteristics of the instruments. Whilst the application of the business model and the contractual cash flow characteristics tests will result in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39, this is not expected to materially impact the Group.

Impairment
Impairment will be based on a more forward looking expected credit loss ('ECL') approach for financial assets classified as amortised cost and fair value through other comprehensive income, rather than the incurred loss approach applied under IAS 39.

At initial recognition, financial assets are categorised as 'stage 1' and an impairment provision is required for ECL resulting from default events projected within the next 12 months ('12-month ECL'). Subsequently, financial assets are considered to be in 'stage 2' when their credit risk has increased significantly since initial recognition so it is appropriate to recognise lifetime ECL. The Group will assess loans to be in stage 2 when the accounts are more than 30 days past due or there has been a significant relative increase in the lifetime probability of default (PD) compared to initial recognition, and where the PD for retail mortgages is derived based on the customer's credit quality, including analysis of behaviour score and other account characteristics.

The threshold applied to assess whether a significant relative increase has occurred will depend on the credit quality at initial recognition, with a lower percentage change in PD being required for higher risk accounts. For non-retail portfolios, the Group will assess a significant increase in credit risk using a combination of individual and collective information, including monitoring through the watchlist process.

Financial assets will be included in 'stage 3' when there is objective evidence that the loan is credit impaired, with expected credit losses still calculated on a lifetime basis. The objective evidence that is used to determine whether a loan is impaired is whether they are more than 90 days past due, have been renegotiated for credit risk reasons, or otherwise considered to be in default (including possession, insolvency and assets beyond term expiry). The Group's use of forbearance tools is detailed on page 164 with arrears arrangements, payment holiday, term extension, transfers to interest only and interest capitalisation all being included in the criteria for identifying the stage 3 accounts. The population of stage 3 loans will be similar to that of impaired loans under IAS 39. The impairment provision will be determined using the same calculation as stage 2, but with the PD set to 100%. The calculated provision will therefore differ from that calculated under IAS 39.

The core retail model has been running in parallel to the IAS 39 impairment calculation since July 2017. This model covers 87% of the financial assets in scope of the IAS 39 impairment calculation, and covers all inputs to appropriately model ECLs such that no manual adjustments are required to the calculation in determining the provision amount.

ECLs are calculated at the individual loan level using three main components, i.e. PD, a loss given default ('LGD') and the exposure at default ('EAD'). The LGD represents losses expected on default, taking into account the mitigating effect of collateral, its expected value when realised and the time value of money. The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default.

The Group have based the ECL calculations for retail portfolios on those used to calculate Basel expected losses ('ELs') given the similarities in the calculations. However, the IFRS 9 approach has been further developed to meet IFRS 9 requirements, including:

- Calculation of a separate PD, EAD and LGD for every month that a financial asset is due to be outstanding.
- PD is based on a point in time calculation based on current conditions, adjusted to take into account estimates of future conditions that will impact PD. A default backstop of 90+ days past due has also been applied.
- EAD has been modelled based on expected payments over the term and is not floored at the current balance.

Introduction continued...

- LGD is based on an estimate of loss given default including the expected impact of future economic conditions such as changes in value of collateral and does not include any floors. Only costs associated with obtaining/ selling collateral are included.
- Discounting of the expected cash flows is performed using the effective interest rate of the loan.

In addition, the IFRS 9 PD and LGD estimates have to be flexed to capture the effects of forward-looking macroeconomic variables (including interest rates, unemployment, house prices and inflation). The Group has used existing stress testing models to measure these effects, with the calculated provision having a significant sensitivity to these macroeconomic variables and the probability weightings applied to these.

Financial assets that are considered credit impaired on initial recognition are required to have ECLs measured on a lifetime basis, and cannot be transferred to stage 1 or 2 even if the credit quality of these assets improves. The Group as at the transition date had loans acquired as part of the Chelsea and N&P mergers which are considered credit impaired on initial recognition. This includes commercial loans, interest-only mortgages and mortgage lending in Spain and Gibraltar. The ECL modelling for the acquired credit impaired assets is performed outside of the model used for originated mortgages as these have very different risk characteristics that could not be robustly forecast within this model. The ECL calculations are based on consistent principles with those described for the core mortgage model with the assumptions and inputs tailored to meet the characteristics of these portfolios.

A new committee, supported by Finance, Credit Risk, Balance Sheet Management and economic experts, has been established to consider and approve the forward-looking macroeconomic assumptions, with the objective of developing internally coherent economic scenarios. This committee is charged with ensuring that ECL allowance meets the IFRS 9 measurement principle for unbiased and probability weighted amounts derived by evaluating a range of possible outcomes and assumptions. The Committee will review the findings from the regular model governance reviews that will be performed to ensure that the approach and assumptions remain appropriate.

Hedge accounting
The IFRS 9 hedge accounting requirements aim to simplify hedge accounting and permit application to a wider population of economic hedge relationships. IFRS 9 does not explicitly address macro hedge accounting strategies, which are particularly important for banks and building societies. As a result, IFRS 9 includes an accounting policy choice to continue applying the IAS 39 hedge accounting requirements. The Group will continue to do so as at 1 January 2018.

Adoption of the IFRS 9 hedge accounting requirements has the potential to reduce fair value volatility for the Group in future periods as changes in the valuation of cross currency swaps from movements in foreign currency basis may be recorded in other comprehensive income rather than the income statement. The Group continues to monitor the adoption decision and will advise in the interim financial statements if a decision is taken to adopt.

Transition
The classification, measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The Group does not intend to restate comparatives.

The PD and LGD models of the IFRS 9 impairment calculation have been based on those used for Basel EL reporting. The related Basel models have been undergoing recalibration in order to incorporate the latest regulatory requirements and available data. The IFRS 9 impairment calculations are similarly being refined to capture a new behaviour score in the PD model, revised LGD methodology and re-assessment of the thresholds used to assess whether credit risk has increased significantly. The final impact will also be dependent on the macroeconomic assumption applied to the transition date.

As at 31 December 2017, the Group had an IAS 39 impairment provision of £32.5m and a credit related fair value adjustment for acquired assets of £45.8m. The Group estimates that the IFRS 9 provision will not be materially different to the existing IAS 39 impairment provision.

There will be no change to the write off policy applied under IFRS 9. Loans will continue to be normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security.

Accounting developments – other

In the current year, the Group has applied a number of amendments to IFRSs issued by the International Accounting Standards Board (IASB) that were mandatorily effective. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

- Amendments to IAS 7 'Disclosure Initiative' which require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. These disclosures are included on page 99.
- Amendments to IAS 12 'Recognition of Deferred Tax Assets for Unrealised Losses' which clarifies how an entity should evaluate whether there will be sufficient future taxable profits against which it can utilise a deductible temporary difference.
- Annual improvements to IFRSs 2014-2016 Cycle included amendments to IFRS 12 that an entity need not provide summarised financial information for interests in subsidiaries, associates or joint ventures that are classified as held for sale.

Notes to the Accounts continued...

1. Significant Accounting Policies

The following Standards which have not been adopted in these financial statements were in issue but not yet effective for the 2017 year end. Except otherwise stated, the adoption of the following new or amended standards are not expected to have material impact on the financial statements.

- IFRS 15 'Revenue from Contracts with Customers' is effective for periods beginning on or after 1 January 2018. IFRS 15 introduces a framework for determining whether, how much and when revenue is recognised and it replaces the existing guidance in IAS 18 'Revenue'. The Group has assessed the potential impact from adopting IFRS 15; and it is not expected to have a material impact on the financial statements.
- IFRS 16 'Leases' is effective for periods beginning on or after 1 January 2019. IFRS 16 eliminates the distinction between operating and finance leases that currently exists in IAS 17, with virtually all leases recognised on balance sheet. The Group is assessing the potential impact of adopting IFRS 16 which is expected to result in an increase in lease assets and financial liabilities for leases classified as operating leases under IAS 37. The Group had non-cancellable operating lease commitments of £33.4m as at 31 December 2017, as per Note 32. The Group expects to provide further detail on the transition impact from IFRS 16 in the 2018 interim financial statements.
- IFRS 17 'Insurance Contracts' is effective for periods beginning on or after 1 January 2021. IFRS 17 is the comprehensive IFRS establishing specific accounting requirements for insurance contracts. This replaces IFRS 4 for which entities were permitted to account for insurance contracts differently across jurisdictions.
- Amendments to IFRS 2 'Classification and Measurement of Share-based Payment Transactions', IFRS 4 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts', IAS 40 'Transfers of Investment Property', IFRS 1 'Annual Improvements to IFRSs 2014-2016 Cycle', IAS 28 'Annual Improvements to IFRSs 2014-2016 Cycle', IFRS 10 'Sale or Contribution of Assets between an Investor and its Associate or Joint Venture' and IAS 28 'Sale or Contribution of Assets between an Investor and its Associate or Joint Venture'.

Basis of consolidation

The Group financial statements consolidate the financial statements of the Society and entities controlled by the Society (its subsidiary undertakings). Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated upon consolidation.

Investments in subsidiary undertakings are stated in the Society accounts at cost less any provisions for impairment.

Dividend income

Dividend income from investments is recognised when the shareholders' rights to receive the payment have been established.

Interest income and expense

Interest income and expense on all financial instruments are recognised within interest receivable or payable on an effective interest rate basis.

The effective interest rate method is used to calculate the amortised cost of financial instruments and to recognise interest income and expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash flows (excluding credit losses) through the expected life of the instrument to the net carrying amount on initial recognition. The main impact for the Group relates to mortgage advances where fees (such as application and arrangement fees) and costs are incorporated in the calculation. This has the effect of spreading these fees and costs over the expected life of the mortgage. Expected lives are estimated using historic data and management judgement and the calculation is adjusted when actual experience differs from estimates, with changes in deferred amounts being recognised immediately in the Income Statement.

Fees and commissions

Fees payable and receivable in relation to the provision of loans and origination of funding are accounted for on an effective interest rate basis. Other fees and commissions are recognised on an accruals basis when the relevant service is provided.

Other operating income

Other operating income primarily comprises income from fixed assets; specifically profits on disposal, rental income from investment property and software licensing income.

The material reduction in other operating income in the year is due to exceptional one-off items in the prior period, being the sale of branch properties at King's Road, Croydon and Westminster.

Classification of financial instruments

Financial assets and liabilities are recognised in the Group's Statement of Financial Position when the Group becomes a party to the contractual provisions of the instrument. Financial assets and liabilities are initially measured at fair value.

The Group initially records all of its financial liabilities at fair value less directly attributable transaction costs, and subsequently measures them at amortised cost, other than derivative financial instruments and where an adjustment is made as part of a fair value hedging arrangement. Interest expense is recognised on an effective interest rate basis.

Financial assets are classified into the following specified categories: financial assets 'at fair value through profit or loss', 'held-to-maturity' investments, 'available for sale' financial assets and 'loans and receivables'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

1. Significant Accounting Policies continued...

Loans and receivables are predominantly mortgage loans to customers and money market advances held for liquidity purposes. They are initially recorded at fair value adjusted for any attributable costs or fees and are subsequently held at amortised cost less any impairment losses other than where an adjustment is made as part of a fair value hedging arrangement. Income is recognised on an effective interest rate basis.

Financial assets at fair value through profit and loss comprise assets that have been specifically designated as such at inception and certain structured investments containing embedded derivatives where the Group has been unable to separately calculate the fair value of the embedded derivative. Where the embedded derivative has not been separated from the host instrument the entire (hybrid) instrument has been recorded at fair value. Gains and losses arising from changes in fair value are recognised in the Income Statement. Interest income arising from financial assets measured at fair value through profit and loss is recognised on an effective interest rate basis.

Held to maturity investments comprise assets which the Group has both the intention and ability to hold to maturity. This category contains certain assets that have been specifically designated at inception and other assets that have been reclassified where we have the intention and ability to hold to maturity. They are initially recorded at fair value adjusted for any attributable costs or fees and are subsequently held at amortised cost less any impairment losses. Income is recognised on an effective interest rate basis.

Available for sale financial assets are securities held for liquidity and investment purposes. They comprise all non-derivative financial assets that are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit and loss. These are recorded at fair value with changes in value being taken to reserves. Interest is recognised on an effective interest rate basis. Where the asset is disposed of, the cumulative gain or loss previously recognised in reserves is reclassified to the Income Statement.

Derivative financial instruments and embedded derivatives

The Group enters into a variety of derivative financial instruments to manage its risk exposure to interest rate, foreign exchange and equity prices. Derivative financial instruments are held at fair value with movements in fair value being recognised in the Income Statement. Fair values of derivatives are measured using valuation techniques including discounted cash flow models. Further details of derivative financial instruments are disclosed in Note 34.

Certain derivatives are embedded in other financial instruments. These are treated as separate derivatives where the economic characteristics and risks are not closely related to the host instrument and the host instrument is not measured at fair value. These embedded derivatives are measured at fair value with movements in value being recognised in the Income Statement. Where the Group is unable to value the embedded derivative separately, the entire instrument is measured at fair value with changes in value being taken to the Income Statement.

Hedging

All derivatives entered into by the Group are for the purposes of providing an economic hedge. Full details of hedging strategies are contained in Note 34. Hedge accounting is applied when the specific rules and conditions in IAS 39 are fulfilled. The Group has classified the majority of its derivatives as fair value and cash flow hedges in order to reduce volatility in the Income Statement.

Where the fair value hedging requirements are met, changes in the fair value of the hedged item arising from the hedged risk are taken to the Income Statement thereby offsetting the effect of the related movements in the fair value of the derivative. Where the hedge no longer meets the criteria, or is terminated for any other reason, the adjustment to the hedged item is released to the Income Statement, over its remaining life, using the effective interest rate method.

Where a derivative financial instrument is designated as a hedge of the variability in the cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity and recycled to the Income Statement over the life of the forecast transaction. Any ineffective portion of the gain or loss on the hedging instrument is recognised in the Income Statement immediately. If the forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss recognised in equity is then recognised immediately in the Income Statement.

Impairment of financial assets

At each reporting date the Group assesses whether or not there is objective evidence that individual financial assets (or groups of financial assets with similar credit characteristics) are impaired. In determining whether an impairment loss should be recognised, the Group makes judgements as to whether there is any evidence indicating a measurable decrease in the future cash flows expected from a financial asset or group of financial assets, resulting from an event (or events) that have occurred after initial recognition of the asset, but before the reporting date.

Individual assessments are made of all loans and advances on properties which are in possession or in arrears by three months or more. All other loans and advances are grouped according to their credit characteristics and a collective review is undertaken of any evidence of impairment. In all cases, future cash flows are estimated on grouped credit characteristics. The collective impairment provision includes an allowance against the risk of customer indebtedness arising from circumstances in existence at the reporting date, as these customers may be able to maintain their repayments only whilst interest rates remain low.

Where there is objective evidence of impairment or that trigger events exist at the reporting date, then the impairment loss is calculated as the difference between the assets' carrying value and the present value of the estimated cash flows from those assets. In assessing these cash flows a number of factors are taken into account, including the Group's historic default experience, historic and current loss emergence periods, the

Notes to the Accounts continued...

1. Significant Accounting Policies continued...

effect of changes in house prices, credit bureau data and adjustments to allow for ultimate forced sale discounts.

The Group grants concessions to assist borrowers who experience difficulties in meeting their obligations to pay their mortgage (referred to as forbearance) as described in Note 39. Forbearance is included in the loan loss provision similar to other debt, whereby debt which is more than three months in arrears is treated as individually impaired. Debt which is less than three months in arrears is included in the calculation of the collective impairment provision.

Any increases or decreases in projected impairment losses are recognised through the Income Statement. If a loan has no realistic prospect of recovery, any loss incurred by the Group on extinguishing the debt is written off against the provision for loan impairment. Any subsequent recoveries of amounts previously written off are recognised through the Income Statement.

Derecognition of financial assets and liabilities

Financial assets are only derecognised when the contractual rights to receive cash flows from the financial assets have expired, or when the Group has transferred substantially all risks and rewards of ownership. The Group has not derecognised the loans securing its issue of covered bonds and securitisations because substantially all the risks and rewards are retained. Collateralised borrowing is recognised for the proceeds received. Financial liabilities are only derecognised when the obligation is discharged, cancelled, or has expired.

Segmental reporting

The chief operating decision maker has been identified as the Board of directors, which reviews the Group's internal reporting and is responsible for all significant decisions.

Financial information provided in the segmental reporting note is consistent with that which is presented to the Board. No segmental information is presented on geographical lines due to substantially all of the Group's activities being in the United Kingdom.

Business combinations between mutual organisations

Identifiable assets and liabilities were measured at fair value on merger. Intangible assets are amortised through the Income Statement over their estimated useful lives, being between one and 10 years.

Cash and cash equivalents

For the purposes of the Statements of Cash Flows, cash and cash equivalents comprise cash and other financial instruments with less than three months' original maturity. The Statements of Cash Flows have been prepared using the indirect method.

Investment properties, property, plant and equipment

Investment properties comprise freehold properties and parts of freehold properties that are not used in the business. These properties are generally flats and offices ancillary to branch premises and earn rental income. Investment properties are stated at cost less accumulated depreciation and any recognised impairment loss.

Buildings, major alterations to office premises, fixtures and fittings, equipment and other tangible fixed assets are stated at cost less accumulated depreciation and any recognised impairment loss. Costs incurred after the initial purchase of assets are expensed unless it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Repairs and maintenance are treated as an expense.

Depreciation is recognised so as to write off the cost (other than land) less the residual value by equal instalments over estimated useful economic lives as follows:

Freehold/long leasehold buildings (including investment properties) – 50 years

Short leasehold property – Life of lease

Equipment, fixtures, fittings and vehicles – three to 20 years

Freehold land is stated at cost less accumulated impairment losses and is not depreciated.

The carrying values of investment properties and property, plant and equipment are reviewed for impairment where there is an indication that events or circumstances may mean that the carrying amount is not recoverable. Where the recoverable amount of the asset is estimated to be less than the carrying amount, the carrying amount is written down immediately to the recoverable amount.

Any impairment in the value of assets is dealt with through the Income Statement as it arises.

Intangible assets

Computer software includes development costs, purchased software and internally generated assets as shown in Note 17.

Costs incurred in the development of computer software for internal use are capitalised as intangible assets where the expenditure leads to the creation of an identifiable non-monetary asset and it is probable that the expected future economic benefits that are attributable to the asset will flow to the Group. Purchased software is classified as an intangible asset where it is not an integral part of the related hardware. Computer software costs are amortised over their estimated useful lives, which are generally three to five years.

Computer software is tested for impairment at each reporting date or when there is an indication of impairment. 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. In assessing value in use, the estimated future cash flows are discounted to their present value. If the recoverable amount of the asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. Any impairment in the value of these assets is recognised in the Income Statement as it arises.

Other intangibles, which largely represent core deposit intangibles acquired by the Group, are amortised using the straight line method over their estimated useful lives of between one and 10 years.

1. Significant Accounting Policies continued...

Retirement benefit costs

Payments to defined contribution pension schemes are recognised as an expense when employees have rendered service entitling them to the contributions.

The asset or liability recognised in respect of the defined benefit pension scheme is the present value of the defined benefit obligation at the reporting date less the fair value of plan assets, together with adjustments for unrecognised past service costs. An asset is only recognised to the extent that it is recoverable by the Group, being the present value of available refunds and reductions in future contributions to the scheme. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. Projected benefit obligations are discounted to present value using the rate of return available on high quality corporate bonds of equivalent currency and term to the obligations. Actuarial gains or losses are recognised in full in the period in which they occur in the Statement of Comprehensive Income. Past service costs are recognised immediately in the Income Statement to the extent that benefits are already vested and otherwise are amortised on a straight-line basis over the average period until the benefits become vested.

Tax

Tax 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 equity, in which case the tax is recognised in the Statement of Comprehensive Income.

Current tax is the expected tax payable on the taxable profits for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised for temporary differences arising between the carrying amount of certain assets and liabilities for accounting purposes and for taxation purposes. Deferred tax is provided using tax rates enacted or substantively enacted at the reporting date, depending on the date at which they are expected to reverse.

The following temporary differences are not provided for:

- The initial recognition of assets or liabilities that affect neither accounting nor taxable profit.
- Differences relating to investments in subsidiaries, to the extent that the parent is able to control the reversal of temporary differences and it is probable they will not reverse in the foreseeable future.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available, against which temporary differences can be utilised. The carrying amount of the deferred tax asset is reviewed at the reporting date, and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. The asset is recorded in the Statement of Financial Position within property, plant and equipment and is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses. Depreciation is provided by the Group to write off the cost over the estimated useful economic life of the asset. Future instalments under such leases, net of finance charges, are included within payables. Rent payable on finance leases is apportioned between the finance element, charged to the Income Statement, and the reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.

All other leases are classified as operating leases. Operating lease rentals are expensed to the Income Statement on a straight-line basis over the period of the lease agreement.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan through announcing its main features to those affected by it.

Present obligations arising under onerous contracts are recognised and measured as provisions. An onerous contract is considered to exist where the Group has a contract under which the unavoidable costs of meeting its contractual obligations exceed the economic benefits expected to be received under it.

Foreign currency

Assets and liabilities denominated in foreign currencies are translated into Sterling at the appropriate rates of exchange prevailing at the reporting date and exchange differences are recognised in the Income Statement as they arise. All income and expense is translated into Sterling at the rate of exchange on the day of receipt or payment.

Notes to the Accounts continued...

2. Critical accounting judgements and key sources of estimation uncertainty

The Group makes judgements in applying its accounting policies that have a significant impact on the amounts recognised in the financial statements. In addition estimates and assumptions are used which could affect the reported amounts of assets and liabilities in the next financial year.

The estimates and underlying assumptions are reviewed on an ongoing basis. As explained on pages 58 to 59, the Audit Committee has confirmed that the accounting judgements and estimates applied are considered to be appropriate.

Critical judgements

The following are the critical judgements, apart from those involving estimations (which are dealt with separately below), that the directors have made in the process of applying the Group's accounting policies.

Pensions

International Financial Reporting Interpretations Committee statement 14 (IFRIC 14) requires that a net defined benefit asset should only be recognised to the extent that an entity has the ability to access the pension scheme surplus in the form of a refund or reduction in future contributions. This requires judgement to be made around the legal rights to which the scheme trustees could unilaterally act in order to restrict the availability of the entity to seek a refund or reduction in future contributions. The Group operates a defined benefit pension scheme for which it has received a legal opinion that it can recover in full any surplus of the scheme. The Group has recognised an asset in respect of the surplus as at both December 2016 and 2017. Whilst the Group is unable to release funds from the scheme and the asset would not be crystallised in full if the pension obligations were settled immediately, the asset has been recognised based on the obligations being settled as they fall due and the surplus being used to reduce future contributions or repaid after all settlements have occurred. This includes an assessment that the pension scheme trustees are unable to act, without the Society's support, to amend the scheme rules and ultimately prevent the Society accessing the surplus.

Effective interest rate

IAS 39 requires that all of the cash flows directly associated with financial instruments held at amortised cost must be recognised in the Income Statement through the interest margin using the effective interest rate method. This includes the cash flows for arrangement fee, introducer fees, incentive arrangements and early repayment charges. When this approach is applied to a mortgage portfolio, judgements must be made to estimate the average life of that portfolio. These judgements are applied to segments of the mortgage portfolio, taking into account factors including the terms of the particular products, historic repayment data and economic conditions.

Key sources of estimation uncertainty

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting period that may have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities with the next financial year, are discussed below.

Impairment of loans and advances to customers

The calculation of impairment provisions for a portfolio of mortgage loans is inherently uncertain. Provisions are calculated using historic default and loss experience but require judgement to be exercised in predicting future economic conditions (e.g. interest rates and house prices) and customer behaviour (e.g. default rates). Retail mortgages account for 99% of the Group's loan book and 100% of the Group's impairment provision. As such, sensitivities around our commercial book and other loans would not have a significant impact on the provision. In relation to retail mortgages the most critical sources of estimation uncertainty are:

- the future level of house prices where an 11.6% fall for 2018 has already been captured in our impairment calculation. A 10% absolute change in this factor to either 1.6% or 21.6% would give rise to a £7.6m decrease or increase in the provision, respectively; and
- the probability of possession (PP) rates for customers who are indebted on their unsecured lending or using a high proportion of their available credit. The provision in relation to such customers is £21.8m of the total impairment provision of £32.5m. A 20% relative increase in the PP for these customers would lead to a £4.4m increase in the impairment provision, with a similar size reduction in provision for a 20% relative decrease.

During 2017, the Group has refined its approach for estimating the LGD for customers who are indebted on their unsecured lending or using a high proportion of their available credit. The refinements include amending the scope of the provision to accounts with a sufficiently high LTV ratio that a loss would occur in the event of default; which has been partially offset by increasing the LGD estimate to be based on a proxy to accounts that are three months in arrears or more with similarly high LTV ratios. The weighted average LGD as at December 2017 was 24.0% and applied to loan balances totalling £1,455.5m. This compares to a weighted average LGD as at December 2016 of 16.6% and which had been applied to loan balances totalling £2,479.3m.

Fair values arising from business combinations

As described on page 104, identifiable assets and liabilities are initially measured at fair value. The fair value, as at December 2017, of assets acquired as part of the business combinations included £45.8m in respect of expected credit losses. The calculation of the expected loss is inherently uncertain and contains estimates around future economic conditions (e.g. interest rates and house prices) and customer behaviour (e.g. default rates). The expected credit losses include £19.6m in respect of interest only mortgage accounts acquired from Chelsea Building Society, where there is significant uncertainty as to the PD and LGD. The Group has only been able to substantiate the existence of an appropriate principal repayment vehicle for 24% of these customers and there is a risk that the Group will be unable to collect the full

2. Critical accounting judgements and key sources of estimation uncertainty continued...

amount due at maturity (average maturity being 2028). The Group applies a model to estimate the probability of accounts that reach the end of term not being recovered, with the average probability across these accounts being 25.5%. If the average probability decreased to 15.5% or increased to 35.5%, the expected credit loss would decrease by £7.6m or increase by £7.7m, respectively.

Pensions

Significant judgements (on areas such as future interest, salary escalation and mortality rates) have to be exercised in estimating the value of the assets and liabilities of the defined benefit scheme, and hence of its net surplus/deficit. These are outlined in Note 26. The impact of a 1.0% absolute decrease in the rate used to discount the future value of the assets and liabilities (from 2.4% to 1.4%) would be to increase the surplus by £21.1m. The impact of a 0.75% increase in the salary escalation rate would be to decrease the surplus by £10.1m. The impact of a one year increase in each of the quoted life expectancies at age 60 would be to decrease the surplus by £31.5m.

Regulatory and other provisions

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the reporting date, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows. Note 28 provides details of regulatory and other provisions which include amounts provided in relation to customer redress claims related to past sales of PPI totalling £21.3m. This provision is calculated using management's best estimate of the complaint volumes, average redress payments, referral rates to the FOS, complaint handling costs and other costs.

The principal uncertainty in the calculation of the PPI provision is the complaint volumes for which historical levels have been volatile and will be impacted by the FCA media campaign. This gives rise to a material estimation uncertainty for the Society. The average monthly successful complaint volume estimated to be received from January 2018 to the August 2019 deadline is 346. This is 66% higher than the average actual successful monthly volume of complaints of 208 received throughout 2017, and is based on the significant increase observed during the last quarter of 2017 following the FCA advertising campaign continuing to impact claim volumes in 2018 and 2019. If actual successful complaint volumes end up being in line with 2017 actuals, this would lead to £5.6m of lower payments compared to that provided as at December 2017, whereas a further 33% increase in claim volumes would lead to £4.6m of additional payments.

Notes to the Accounts continued...

3. Interest receivable and similar income

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
On assets held at amortised cost				
Loans secured on residential property	**957.6**	1,050.8	**475.1**	552.4
Connected undertakings	**–**	–	**374.5**	411.7
Other loans	**19.4**	18.6	**19.4**	18.6
Other liquid assets/cash and short-term funds	**11.3**	15.2	**11.2**	14.8
On available for sale securities	**6.8**	7.1	**6.8**	7.1
On held to maturity securities	**–**	–	**40.5**	38.5
On financial instruments held at fair value through the Income Statement				
Derivatives	**83.1**	87.0	**59.5**	59.3
Other assets	**–**	0.1	**–**	0.1
Total interest receivable	**1,078.2**	1,178.8	**987.0**	1,102.5

Included within interest receivable and similar income is interest earned on individually impaired loans: Group £2.6m, Society £1.2m (2016: Group £4.2m, Society £1.7m).

4. Interest payable and similar charges

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
On liabilities held at amortised cost				
Shares held by individuals	**286.6**	384.7	**286.6**	384.7
Deposits from banks	**25.8**	21.7	**25.8**	21.7
Deposits from connected undertakings	**–**	–	**43.9**	38.5
Other deposits	**0.3**	0.7	**0.3**	0.7
Debt securities in issue	**90.0**	86.2	**83.7**	79.8
Subordinated liabilities	**18.8**	15.7	**18.8**	15.7
Subscribed capital	**0.3**	0.3	**0.3**	0.3
Other interest payable	**0.1**	0.5	**0.1**	0.5
On financial instruments held at fair value through the Income Statement				
Deposits from connected undertakings	**–**	–	**27.6**	30.8
Derivatives	**154.2**	193.4	**155.0**	193.0
Total interest payable	**576.1**	703.2	**642.1**	765.7

5. Net gains/(losses) from fair value volatility on financial instruments

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Assets held at fair value	**–**	(0.2)	**–**	(0.2)
Embedded derivatives	**5.7**	0.8	**5.7**	0.8
Derivatives and hedging	**7.4**	0.3	**8.7**	(13.3)
Net gains/(losses) from fair value volatility on financial instruments	**13.1**	0.9	**14.4**	(12.7)

Assets held at fair value relate to structured assets containing profit participation features that meet the definition of embedded derivatives. The Society is unable to separate the value of the embedded derivative from the host item and so has to treat the whole asset as held at fair value through the Income Statement in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'.

The embedded derivative category relates to synthetic features contained in certain structured investments which can be valued separately from the host instruments.

The derivative and hedging category relates to changes in fair value of derivatives that provide effective economic hedges but where the Group has not achieved hedge accounting.

6. Net realised profits

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Net realised profit on sale of debt securities	**6.1**	1.8	**6.1**	1.8
	6.1	1.8	**6.1**	1.8

7. Administrative expenses

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Staff costs				
Salaries and wages	**136.8**	141.5	**136.8**	141.5
Social security costs	**13.8**	14.2	**13.8**	14.2
Pension costs – defined benefit plans	**0.4**	(0.9)	**0.4**	(0.9)
Pension costs – defined contribution plans	**12.0**	12.4	**12.0**	12.4
Other staff costs	**1.1**	0.7	**1.1**	0.7
Operating lease rentals	**8.9**	9.7	**9.1**	9.8
Professional consultancy costs	**24.6**	22.9	**24.6**	22.9
Other expenses	**110.5**	122.8	**110.3**	122.5
	308.1	323.3	**308.1**	323.1

Notes to the Accounts continued...

7. Administrative expenses continued...

The Society operates a salary sacrifice scheme whereby the employee agrees to a reduction in salary in return for the Society making pension contributions that were previously paid by the employee. The amount shown on page 109 under salaries and wages includes the headline salary (i.e. before the salary sacrifice deduction) and Pension costs excludes the additional contributions made by the Society as a result of the salary sacrifice scheme.

The Society's operating lease rentals include payments it makes to subsidiary companies which own properties and equipment.

Remuneration of the auditor and their associates

	Group		Society	
	2017 £000	2016 £000	**2017 £000**	2016 £000
Audit fees for the Group and Society statutory audit	**553**	461	**553**	461
Fees payable for other services:				
Audit of Group subsidiaries	**70**	65	**–**	–
Audit-related assurance services	**153**	147	**153**	147
Total audit and audit related assurance services	**776**	673	**706**	608
Other non-audit services	**–**	19	**–**	19
	776	692	**706**	627

The above figures, relating to auditor's remuneration, exclude Value Added Tax. Details of the Society's policy on non-audit work, which is implemented by the Audit Committee, is given in the Audit Committee Report on page 60.

Staff numbers
The average number of persons employed by the Group during the year (including Executive Directors) was as follows:

	2017		2016	
	Full time	**Part time**	Full time	Part time
Central administration	**2,359**	**558**	2,530	539
Branches	**782**	**521**	971	502
	3,141	**1,079**	3,501	1,041

8. Remuneration of and transactions with directors

Full details of directors' remuneration, bonuses and pensions are given in the Directors' Remuneration Report on pages 70 to 84. In addition, past directors' pensions in respect of services as directors (closed scheme) amounted to £20,000 (2016: £19,000).

None of the directors had any interest in the shareholdings or debentures of any connected undertaking of the Society at any time during the financial year. Details of transactions with directors and loans held by directors and connected persons are disclosed in Note 41.

A register is maintained at the head office of the Society containing details of loans, transactions and arrangements between the Society and its directors and connected persons. A statement containing the details for 2017 will be available for inspection at the head office for a period of 15 days up to and including the Annual General Meeting.

9. Impairment

Loans and advances to customers

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
At 1 January				
Collective	**34.3**	33.3	**5.7**	5.7
Individual	**10.7**	15.7	**0.5**	0.8
	45.0	49.0	**6.2**	6.5
Amounts written off during the year				
Collective	**–**	–	**–**	–
Individual	**(4.7)**	(6.3)	**(0.1)**	(0.2)
	(4.7)	(6.3)	**(0.1)**	(0.2)
Impairment adjustment for the year				
Collective	**(9.8)**	1.0	**(3.0)**	–
Individual	**2.0**	1.3	**0.1**	(0.1)
	(7.8)	2.3	**(2.9)**	(0.1)
At 31 December				
Collective	**24.5**	34.3	**2.7**	5.7
Individual	**8.0**	10.7	**0.5**	0.5
	32.5	45.0	**3.2**	6.2
The (release)/charge for the year comprises:				
Impairment adjustment for loans and advances	**(7.8)**	2.3	**(2.9)**	(0.1)
Recoveries relating to amounts previously written off	**(2.0)**	(2.2)	**(1.0)**	(1.3)
Net provision (release)/charge for the year	**(9.8)**	0.1	**(3.9)**	(1.4)

The interest arising from the unwind of the discount of expected future recoveries is not material.

None (2016: none) of the £32.5m (2016: £45.0m) provision balance shown above, and none (2016: none) within the (£9.8m) (2016: £0.1m) net provision (release)/charge, relates to the commercial lending portfolio.

Notes to the Accounts continued...

10. Investments

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Income from subsidiary undertakings	**–**	–	**56.7**	50.0
Other	**3.2**	12.2	**3.2**	12.2
	3.2	12.2	**59.9**	62.2

During 2017, Accord made a dividend payment of £50.0m to the Society (2016: £50.0m). A distribution of £6.7m was made to the Society from a number of subsidiaries wound up in the year.

Other income relates to cash consideration received from the sale of the majority of our shareholding in VocaLink Holdings Limited (VocaLink) to MasterCard.

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Equities	**6.3**	10.3	**6.3**	10.3
Joint ventures	**–**	–	**0.3**	0.3
Subsidiaries	**–**	–	**21,098.8**	17,953.9
	6.3	10.3	**21,105.4**	17,964.5

Investment in equities
The Group holds equity investments relating to participation in banking and credit card service operations which are classified as available for sale assets. The investments are held as available for sale and the valuation technique is detailed in Note 40.

This includes shares received as part of the consideration from the sale of Visa Europe to Visa Inc. where the Group had a small percentage holding as a result of being a member of Visa Europe through our trading activities, and a residual shareholding of VocaLink shares.

Investment in joint venture
The Society does not have material investments in joint ventures. The Society has a 50% interest in a joint venture, MutualPlus Ltd, a branch sharing company incorporated in the United Kingdom and registered in England and Wales. The carrying amount of the investment at 31 December 2017 and 31 December 2016 was £0.3m, however the joint venture was placed into Members' Voluntary Liquidation on 15 December 2016.

10. Investments continued...

Investment in subsidiaries
Society

	Shares £m	Loans £m	Total £m
Cost			
At 1 January 2017	**105.5**	**17,849.2**	**17,954.7**
Additions	**–**	**3,366.5**	**3,366.5**
Repayments	**(0.1)**	**(221.5)**	**(221.6)**
At 31 December 2017	**105.4**	**20,994.2**	**21,099.6**
Impairment losses			
At 1 January 2017	**(0.5)**	**(0.3)**	**(0.8)**
Written off	**–**	**–**	**–**
Released in the year	**–**	**–**	**–**
At 31 December 2017	**(0.5)**	**(0.3)**	**(0.8)**
Net book value			
At 31 December 2017	**104.9**	**20,993.9**	**21,098.8**
Cost			
At 1 January 2016	106.3	16,655.0	16,761.3
Additions	–	2,001.6	2,001.6
Repayments	(0.8)	(807.4)	(808.2)
At 31 December 2016	105.5	17,849.2	17,954.7
Impairment losses			
At 1 January 2016	(0.5)	–	(0.5)
Written off	–	(0.3)	(0.3)
Released in the year	–	–	–
At 31 December 2016	(0.5)	(0.3)	(0.8)
Net book value			
At 31 December 2016	105.0	17,848.9	17,953.9

All shares held are equity shares. All loans are charged interest which is included within the net interest margin.

Notes to the Accounts continued...

10. Investments continued...

The Society has the following principal subsidiary undertakings, all of which are audited and consolidated.

Subsidiary	Principal activity
Accord Mortgages Limited	Mortgage lending
BCS Loans and Mortgages Limited	Non-trading
YBS Properties (Edinburgh) Limited	Property holding
Yorkshire Key Services Limited	Non-trading
Yorkshire Building Society Covered Bonds LLP	Mortgage acquisition and guarantor of covered bonds
Brass No.3 PLC	Funding vehicle
Brass No.3 Mortgage Holdings Limited	Holding company
Brass No.4 PLC	Funding vehicle
Brass No.4 Mortgage Holdings Limited	Holding company
Brass No.5 PLC	Funding vehicle
Brass No.5 Mortgage Holdings Limited	Holding company
Brass No.6 PLC	Funding vehicle
Brass No.6 Mortgage Holdings Limited	Holding company
Norwich and Peterborough Insurance Brokers Limited	Non-trading
Norwich and Peterborough (LBS) Limited	Mortgage finance
Tombac No.1 PLC	Funding vehicle
Tombac No.1 Mortgage Holdings Limited	Holding company
Tombac No.2 PLC	Funding vehicle
Tombac No.2 Mortgage Holdings Limited	Holding company

For certain subsidiaries, the Group has taken advantage of the audit exemptions available for small and dormant subsidiaries under Sections 479 and 480 of the Companies Act 2006. The Group has adopted such audit exemptions for the following subsidiary undertakings which are largely non-trading for the year ended 31 December 2017:

Brass No.1 PLC
Brass Mortgage Holdings Limited
Brass No.2 PLC
Brass No.2 Mortgage Holdings Limited
Chelsea Mortgage Services Limited
Norwich and Peterborough Covered Bonds LLP
Norwich and Peterborough Estate Agents Limited **
Norwich and Peterborough Sharedealing Services Limited *
YBS Limited
YBS Covered Bonds Finance (Holdings) Limited
YBS Covered Bonds Finance Limited
YBS Group Limited
YBS Investments (No. 1) Limited **
YBS Investments (No. 2) Limited **
YBS Properties Limited
YBS Properties (York) Limited *
Yorkshire Direct Limited
Yorkshire Estate Agents Limited *
Yorkshire Group Limited
Yorkshire Guernsey Ltd
Yorkshire Insurance Services Limited
Yorkshire Key Services (No. 2) Limited *
Yorkshire Life Assurance Services Limited
Yorkshire Mortgage Services Limited
Yorkshire Personal Financial Services Limited
Yorkshire Property Services Limited
Yorkshire Services Limited

*Companies dissolved on 2 January 2018.
**Companies dissolved on 30 January 2018.

All subsidiaries have an accounting period of the 31 December. All the companies are registered in England and operate in the United Kingdom, except Yorkshire Guernsey Ltd which is registered in Guernsey and is non-trading. The registered office of all the wholly owned subsidiary companies and Yorkshire Building Society Covered Bonds LLP is Yorkshire Drive, Bradford, BD5 8LJ.

All the entities are wholly owned except for Yorkshire Building Society Covered Bonds LLP, YBS Covered Bonds Finance (Holdings) Limited, YBS Covered Bonds Finance Limited, Brass No. 1 PLC (in liquidation), Brass Mortgage Holdings Limited (in liquidation), Brass No. 2 PLC, Brass No. 2 Mortgage Holdings Limited, Brass No. 3 PLC, Brass No. 3 Mortgage Holdings Limited, Brass No. 4 PLC, Brass No. 4 Mortgage Holdings Limited, Brass No. 5 PLC, Brass No. 5 Mortgage Holdings Limited, Brass No. 6 PLC, Brass No. 6 Mortgage Holdings Limited, Tombac No. 1 PLC, Tombac No. 1 Mortgage Holdings Limited, Tombac No. 2 PLC and Tombac No. 2 Mortgage Holdings Limited (where the registered office is Third Floor, 1 King's Arms Yard, London EC2R 7AF). The Society's interests in these entities are, in substance, no different than if they were 100% held subsidiary undertakings and consequently they are consolidated in the Group accounts.

11. Tax expense

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Current tax:				
UK corporation tax at 19.25% (2016: 20.00%)	**40.5**	39.4	**25.6**	17.0
Corporation tax – adjustment in respect of prior periods	**0.2**	(0.8)	**0.2**	(0.6)
Total current tax	**40.7**	38.6	**25.8**	16.4
Deferred tax (Note 20):				
Current year	**1.1**	(2.3)	**(1.5)**	1.7
Adjustment in respect of prior periods	**(0.4)**	1.0	**(0.4)**	0.9
Total tax expense in Income Statement	**41.4**	37.3	**23.9**	19.0

The actual tax expense for the year differs from that calculated using the standard rate of corporation tax in the UK. The differences are explained below:

	Group		Society	
	2017	2016	**2017**	2016
	£m	£m	**£m**	£m
Profit before tax	**165.8**	151.5	**107.6**	97.5
Tax calculated at a tax rate of 19.25% (2016: 20.00%)	**31.9**	30.3	**20.7**	19.5
Effects of:				
Income not subject to tax	**(0.3)**	(1.7)	**(11.2)**	(9.0)
Expenses not deductible for tax purposes	**4.8**	3.7	**8.7**	4.1
Banking surcharge	**5.6**	3.9	**5.6**	3.9
Adjustment to tax charge in respect of previous periods	**(0.2)**	0.2	**(0.2)**	0.3
Change in tax rate	**(0.4)**	0.9	**0.3**	0.2
Total tax expense in Income Statement	**41.4**	37.3	**23.9**	19.0
Tax expense/(credit) recognised directly in equity:				
Tax on available for sale securities	**1.0**	2.3	**1.0**	2.3
Effect of change in tax rate	**(0.1)**	(0.3)	**(0.1)**	(0.3)
Tax on re-measurement of net retirement benefit obligations	**13.5**	(7.6)	**13.5**	(7.6)
Effect of change in tax rate	**(1.2)**	–	**(1.2)**	–
Deferred tax on cash flow hedges	**1.6**	5.7	**1.6**	5.7
Effect of change in tax rate	**(0.1)**	(0.3)	**(0.1)**	(0.3)
	14.7	(0.2)	**14.7**	(0.2)

The main rate of UK corporation tax will reduce to 17% from 1 April 2020.

This rate change is reflected in the financial statements resulting in a credit of £0.4m (2016: £0.9m charge) to the Income Statement and a credit of £1.4m (2016: £0.6m) to Other Comprehensive Income in the period, giving an overall credit of £1.8m (2016: £0.3m charge) in respect of the Group's net deferred tax liability.

The effective tax rate for the year is 24.97% (2016: 24.62%) which is higher than the statutory corporation tax rate of 19.25% (2016: 20.00%). The effective tax rate is increased due to a charge of £5.6m (2016: £3.9m) in respect of the banking surcharge which is charged at a rate of 8.00% (2016: 8.00%) on the Society's taxable profits above £25.0m.
The tax rate for the year is also increased by disallowable customer redress costs which are included above within expenses not deductible for tax and increase the tax charge by £3.5m (2016: £3.0m).

Notes to the Accounts continued...

12. Segmental reporting

This section analyses the Group's performance by business segment.

The chief operating decision maker has been identified as the Board, which reviews the Group's internal reporting and is responsible for all significant decisions. The Group's reportable segments under IFRS 8 'Operating Segments', based on the information reviewed by the Board, have been determined according to similar economic characteristics and the nature of the products and service. Details of the reportable segments are listed below:

Segment	Description	Basis of aggregation
Retail	Prime residential owner occupied lending, prime intermediary lending and non-owner occupied lending. Traditional member savings, non-traditional savings and sale of general insurance, protection and investment products provided by third parties.	These are the core activities and focus of the Group.
Non-retail	Prime commercial lending portfolio (including social housing).	These ongoing parts of the business support the Group's financial stability and primary businesses but are not considered core and have a non-retail customer base.
Secondary	Non-prime residential owner occupied lending, consumer banking, personal lending, non-prime commercial lending and non-owner occupied lending acquired through mergers.	These elements, originated and acquired through merger, are closed to new business and are historic areas in which the Group no longer operates.
Central	Supporting business units, the Treasury function and other head office Group functions which have not been apportioned across the aforementioned segments.	These operations are not directly customer related.

No segmental information is presented on geographical lines, because substantially all of the Group's activities are in the United Kingdom.

The majority of the Group's revenues are in the form of interest and the Board monitors the Group's net interest income, to assess performance and direct the Group. Therefore interest receivable and similar income has been shown net of interest payable and similar expense.

Recharging of funding across the Group has been included using the Group's internal funds transfer pricing methodology, which includes the cost of raising external funds.

Income and directly attributable costs have been allocated to each segment as applicable, with support costs being apportioned based on levels of employees.

12. Segmental reporting continued...

The accounting policies for the reported segments are consistent with the Group's accounting policies outlined in Note 1.

2017	Notes	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
Net interest income		**365.2**	**20.6**	**22.7**	**93.6**	**502.1**
Non-interest income (net)	**a**	**19.0**	**–**	**–**	**(4.5)**	**14.5**
Net realised profits and fair value		**–**	**–**	**–**	**19.2**	**19.2**
Management expenses	**b**	**(197.3)**	**(2.5)**	**(1.8)**	**(137.9)**	**(339.5)**
Operating profit before provisions		**186.9**	**18.1**	**20.9**	**(29.6)**	**196.3**
Impairment and other provisions		**5.9**	**–**	**(0.6)**	**(35.8)**	**(30.5)**
Profit/(loss) before tax		**192.8**	**18.1**	**20.3**	**(65.4)**	**165.8**
Total assets		**33,274.7**	**1,037.1**	**708.5**	**7,026.9**	**42,047.2**
Total liabilities		**29,389.2**	**–**	**–**	**10,268.2**	**39,657.4**
Equity		**–**	**–**	**–**	**2,389.8**	**2,389.8**

2016	Notes	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
Net interest income		301.1	18.9	28.8	126.8	475.6
Non-interest income (net)	a	22.4	–	–	13.9	36.3
Net realised profits and fair value		–	–	–	2.7	2.7
Management expenses	b	(208.9)	(2.5)	(2.0)	(132.6)	(346.0)
Operating profit before provisions		114.6	16.4	26.8	10.8	168.6
Impairment and other provisions		(7.1)	–	1.2	(11.2)	(17.1)
Profit/(loss) before tax		107.5	16.4	28.0	(0.4)	151.5
Total assets		32,139.0	1,025.3	824.2	5,607.0	39,595.5
Total liabilities		29,354.5	–	–	8,020.1	37,374.6
Equity		–	–	–	2,220.9	2,220.9

Notes

a Non-interest income (net) includes fees and commissions receivable, fees and commissions payable, other operating income and income from investments.

b Management expenses include administrative expenses, depreciation and amortisation.

Notes to the Accounts continued...

12. Segmental reporting continued...

Total income for the reportable segments can be analysed as follows:

2017	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
External income	**633.6**	**36.4**	**33.8**	**(187.2)**	**516.6**
Income from other segments	**(249.4)**	**(15.8)**	**(11.1)**	**276.3**	**–**
Total income	**384.2**	**20.6**	**22.7**	**89.1**	**516.6**

2016	Retail £m	Non-retail £m	Secondary £m	Central £m	Total £m
External income	620.5	35.1	43.6	(187.3)	511.9
Income from other segments	(297.0)	(16.2)	(14.8)	328.0	–
Total income	323.5	18.9	28.8	140.7	511.9

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

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Cash in hand	**10.1**	11.8	**10.1**	11.8
Cash ratio deposit with the Bank of England	**53.1**	51.6	**53.1**	51.6
Other deposits with the Bank of England	**4,830.7**	3,461.6	**4,830.7**	3,461.6
	4,893.9	3,525.0	**4,893.9**	3,525.0

Cash ratio deposits are mandatory requirements of the Bank of England. They are considered to be encumbered assets as they are not available for use in the Group's day-to-day operations. These balances are non-interest-bearing, whereas other deposits are at variable money market rates.

14. Loans and advances to credit institutions

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Loans and advances to credit institutions	**351.0**	542.8	**126.6**	257.2

Included within loans and advances to credit institutions are balances held in collateral accounts relating to swap agreements, and bank account balances held in the Group's Covered Bond and Securitisation programmes. Such items are considered to be encumbered assets as they are not available for use in the Group's day-to-day operations.

Loans and advances to credit institutions are all due within one year.

15. Debt securities

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Debt securities issued by:				
Public bodies	**724.2**	560.5	**724.2**	560.5
Other borrowers	**126.6**	47.6	**126.6**	47.6
Group companies	**–**	–	**5,125.4**	4,617.9
	850.8	608.1	**5,976.2**	5,226.0

All debt securities are listed on a recognised investment exchange. Debt securities of £0.8bn (2016: £0.6bn) are due in over one year. Debt securities issued by Group companies comprise retained investments in the Group's Brass and Tombac securitisation vehicles.

Group	Held at fair value £m	Embedded derivatives £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1 January 2017	**7.6**	**(8.9)**	**609.4**	**–**	**608.1**
Additions	**–**	**–**	**1,031.2**	**–**	**1,031.2**
Disposals and repayments	**(3.0)**	**8.9**	**(802.8)**	**–**	**(796.9)**
Exchange translation	**1.4**	**–**	**(0.4)**	**–**	**1.0**
Other changes in value	**(2.2)**	**–**	**9.6**	**–**	**7.4**
At 31 December 2017	**3.8**	**–**	**847.0**	**–**	**850.8**
Movements in debt securities during the year were:					
At 1 January 2016	9.1	(9.8)	270.2	–	269.5
Additions	–	–	502.4	–	502.4
Disposals and repayments	(3.1)	–	(185.7)	–	(188.8)
Exchange translation	1.4	–	7.6	–	9.0
Other changes in value	0.2	0.9	14.9	–	16.0
At 31 December 2016	7.6	(8.9)	609.4	–	608.1

Notes to the Accounts continued...

15. Debt securities continued...

Society	Held at fair value £m	Embedded derivatives £m	Available for sale £m	Held to maturity £m	Total £m
Movements in debt securities during the year were:					
At 1 January 2017	**7.6**	**(8.9)**	**609.4**	**4,617.9**	**5,226.0**
Additions	**–**	**–**	**1,031.2**	**2,000.0**	**3,031.2**
Disposals and repayments	**(3.0)**	**8.9**	**(802.8)**	**(1,494.9)**	**(2,291.8)**
Exchange translation	**1.4**	**–**	**(0.4)**	**–**	**1.0**
Other changes in value	**(2.2)**	**–**	**9.6**	**2.4**	**9.8**
At 31 December 2017	**3.8**	**–**	**847.0**	**5,125.4**	**5,976.2**
Movements in debt securities during the year were:					
At 1 January 2016	9.1	(9.8)	270.2	3,983.9	4,253.4
Additions	–	–	502.4	2,000.0	2,502.4
Disposals and repayments	(3.1)	–	(185.7)	(1,369.0)	(1,557.8)
Exchange translation	1.4	–	7.6	–	9.0
Other changes in value	0.2	0.9	14.9	3.0	19.0
At 31 December 2016	7.6	(8.9)	609.4	4,617.9	5,226.0

Debt securities have a £6.0m impairment provision held against them which relates entirely to individually assessed collateralised debt obligations. There has been no movement in this provision since 31 December 2016 when it also totalled £6.0m.

The disposals and repayments for the held to maturity category relate entirely to repayments.

A number of debt securities are structured so that they can pay a return over and above their regular coupon. This feature is regarded as an embedded derivative. The Group is unable to value this element separately from the host instrument so, in accordance with IAS 39, has designated these securities as being held at fair value with movements in value being taken to the Income Statement.

A synthetic collateralised debt obligation matured during 2017, which contained an embedded derivative. This embedded derivative was separated from the host instrument and held at fair value with movements in fair value taken to the Income Statement.

16. Loans and advances to customers

	Group 2017 £m	Group 2016 £m	Society 2017 £m	Society 2016 £m
Loans and advances to customers comprise:				
Loans secured on residential property				
Loans fully secured on residential property	**34,579.6**	33,537.3	**15,836.5**	17,011.1
Other loans secured on residential property	**26.4**	19.1	**16.3**	7.3
Unsecured loans	**(0.4)**	(1.2)	**(0.4)**	(1.2)
Loans secured on commercial property	**509.3**	478.4	**509.3**	478.4
Fair value hedging adjustments	**(21.2)**	114.7	**(21.2)**	114.7
Impairment provisions	**(32.5)**	(45.0)	**(3.2)**	(6.2)
	35,061.2	34,103.3	**16,337.3**	17,604.1

Loans and advances to customers are held at amortised cost, with interest and associated costs being recognised in the interest receivable and similar income line of the Income Statement on an effective interest rate basis.

A number of fair value adjustments arose at the time of merging with Norwich & Peterborough Building Society and Chelsea Building Society; such adjustments are included within the relevant loans and advances to customer balances above. Some adjustments relate to provisions for lifetime losses which can be larger than current exposures.

Fair value hedging adjustments of £21.2m (2016: £114.7m) have been made to certain fixed rate mortgages that are in fair value hedging relationships.

Note 35 details the extent to which these assets are encumbered.

Notes to the Accounts continued...

17. Intangible assets

	Development costs £m	Purchased software £m	Internally generated assets £m	Other £m	Total £m
Group					
Cost					
At 1 January 2017	**6.2**	**31.5**	**23.4**	**18.5**	**79.6**
Additions	**4.8**	**7.4**	**–**	**–**	**12.2**
Disposals	**–**	**(0.9)**	**(1.0)**	**–**	**(1.9)**
Transfers	**(3.7)**	**0.5**	**3.2**	**–**	**–**
At 31 December 2017	**7.3**	**38.5**	**25.6**	**18.5**	**89.9**
Amortisation					
At 1 January 2017	**1.1**	**21.3**	**11.1**	**12.0**	**45.5**
Charged in year	**–**	**5.0**	**3.1**	**1.3**	**9.4**
Impairment	**–**	**0.6**	**–**	**4.0**	**4.6**
Disposals	**–**	**(0.8)**	**(1.0)**	**–**	**(1.8)**
Transfers	**–**	**–**	**–**	**–**	**–**
At 31 December 2017	**1.1**	**26.1**	**13.2**	**17.3**	**57.7**
Net book value					
At 31 December 2017	**6.2**	**12.4**	**12.4**	**1.2**	**32.2**
Cost					
At 1 January 2016	6.3	30.3	20.9	18.5	76.0
Additions	3.6	2.6	–	–	6.2
Disposals	(0.5)	(1.7)	(0.4)	–	(2.6)
Transfers	(3.2)	0.3	2.9	–	–
At 31 December 2016	6.2	31.5	23.4	18.5	79.6
Amortisation					
At 1 January 2016	1.1	18.7	8.4	10.5	38.7
Charged in year	–	4.3	3.1	1.5	8.9
Impairment	–	–	–	–	–
Disposals	–	(1.7)	(0.4)	–	(2.1)
Transfers	–	–	–	–	–
At 31 December 2016	1.1	21.3	11.1	12.0	45.5
Net book value					
At 31 December 2016	5.1	10.2	12.3	6.5	34.1

17. Intangible assets continued...

	Development costs £m	Purchased software £m	Internally generated assets £m	Other £m	Total £m
Society					
Cost					
At 1 January 2017	**6.2**	**30.5**	**23.4**	**18.5**	**78.6**
Additions	**4.8**	**7.4**	**–**	**–**	**12.2**
Disposals	**–**	**(0.9)**	**(1.0)**	**–**	**(1.9)**
Transfers	**(3.7)**	**0.5**	**3.2**	**–**	**–**
At 31 December 2017	**7.3**	**37.5**	**25.6**	**18.5**	**88.9**
Amortisation					
At 1 January 2017	**1.1**	**20.3**	**11.1**	**12.0**	**44.5**
Charged in year	**–**	**5.0**	**3.1**	**1.3**	**9.4**
Impairment	**–**	**0.6**	**–**	**4.0**	**4.6**
Disposals	**–**	**(0.8)**	**(1.0)**	**–**	**(1.8)**
Transfers	**–**	**–**	**–**	**–**	**–**
At 31 December 2017	**1.1**	**25.1**	**13.2**	**17.3**	**56.7**
Net book value					
At 31 December 2017	**6.2**	**12.4**	**12.4**	**1.2**	**32.2**
Cost					
At 1 January 2016	6.3	29.3	20.9	18.5	75.0
Additions	3.6	2.6	–	–	6.2
Disposals	(0.5)	(1.7)	(0.4)	–	(2.6)
Transfers	(3.2)	0.3	2.9	–	–
At 31 December 2016	6.2	30.5	23.4	18.5	78.6
Amortisation					
At 1 January 2016	1.1	17.7	8.4	10.5	37.7
Charged in year	–	4.3	3.1	1.5	8.9
Impairment	–	–	–	–	–
Disposals	–	(1.7)	(0.4)	–	(2.1)
Transfers	–	–	–	–	–
At 31 December 2016	1.1	20.3	11.1	12.0	44.5
Net book value					
At 31 December 2016	5.1	10.2	12.3	6.5	34.1

Notes to the Accounts continued...

17. Intangible assets continued...

Other intangible assets primarily comprise the intrinsic value of items acquired on mergers (current accounts, retail savings and brands) and an amount paid for the transfer of a number of employee sharesave schemes to the Society.

Amortisation is provided to write off the cost less the estimated residual value of intangible assets. Amortisation of such assets is charged to the income statement on a straight line basis over their estimated useful economic lives, commencing at the date the assets are ready for use. The useful economic life of purchased software is five years, and 10 years for internally generated and other assets.

Transfers relate to the reclassification of assets from development costs to purchased software and internally generated assets.

Any impairment in the value of intangible assets is dealt with through the Income Statement as it arises. During the period, £0.6m (2016: £nil) of purchased software and £4.0m (2016: £nil) of other intangible assets was written off as the recoverable amount based on the value in use was deemed to be nil.

18. Investment properties

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Cost				
At 1 January	**19.4**	21.9	**19.2**	21.7
Additions	**0.3**	0.2	**0.3**	0.2
Disposals	**(3.3)**	(3.2)	**(3.3)**	(3.2)
Transfers	**–**	0.5	**–**	0.5
At 31 December	**16.4**	19.4	**16.2**	19.2
Depreciation				
At 1 January	**4.4**	5.3	**4.4**	5.3
Charged in year	**0.2**	0.3	**0.2**	0.3
Impairment	**0.1**	–	**0.1**	–
Disposals	**(0.7)**	(1.3)	**(0.7)**	(1.3)
Transfers	**–**	0.1	**–**	0.1
At 31 December	**4.0**	4.4	**4.0**	4.4
Net book value				
At 31 December	**12.4**	15.0	**12.2**	14.8
Fair value				
At 31 December	**17.7**	22.6	**16.9**	22.0

18. Investment properties continued...

Investment properties are generally flats and offices ancillary to branch premises and not used by the Group. Rental income of £1.7m on investment properties has been included within other operating income (2016: £1.8m).

Transfers relate to the reclassification of assets between investment properties and property, plant and equipment, usually due to changes in occupancy.

Depreciation is provided by the Group to write off the cost less the estimated residual value of investment properties (excluding land) by equal instalments over their estimated useful economic life of 50 years.

The carrying values of investment properties are reviewed for impairment where there is an indication that events or circumstances may mean that the carrying amount is not recoverable. Where the recoverable amount of the asset is estimated to be less than the carrying amount, the carrying amount is written down immediately to the recoverable amount. Any impairment in the value of assets is recognised through the Income Statement as it arises.

The fair value of the Group's investment properties at 31 December 2017 has been arrived at predominantly on the basis of external valuations provided by Gerald Eve surveyors, the remaining properties being valued internally by the Group's Estates Manager, an appropriately qualified surveyor. Under IFRS 13 fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.

Notes to the Accounts continued...

19. Property, plant and equipment

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Group				
Cost				
At 1 January 2017	**0.1**	**129.0**	**77.5**	**206.6**
Additions	**–**	**2.5**	**3.2**	**5.7**
Disposals	**–**	**(7.3)**	**(5.3)**	**(12.6)**
Transfers	**(0.1)**	**0.1**	**–**	**–**
At 31 December 2017	**–**	**124.3**	**75.4**	**199.7**
Depreciation				
At 1 January 2017	**–**	**30.6**	**46.7**	**77.3**
Charged in year	**–**	**5.9**	**8.6**	**14.5**
Impairment	**–**	**1.8**	**0.6**	**2.4**
Disposals	**–**	**(3.5)**	**(4.3)**	**(7.8)**
Transfers	**–**	**–**	**–**	**–**
At 31 December 2017	**–**	**34.8**	**51.6**	**86.4**
Net book value				
At 31 December 2017	**–**	**89.5**	**23.8**	**113.3**
Cost				
At 1 January 2016	0.6	138.8	77.2	216.6
Additions	3.5	3.0	5.3	11.8
Disposals	–	(14.9)	(6.3)	(21.2)
Transfers	(4.0)	2.1	1.3	(0.6)
At 31 December 2016	0.1	129.0	77.5	206.6
Depreciation				
At 1 January 2016	–	35.4	43.3	78.7
Charged in year	–	4.1	9.4	13.5
Impairment	–	–	–	–
Disposals	–	(8.8)	(6.0)	(14.8)
Transfers	–	(0.1)	–	(0.1)
At 31 December 2016	–	30.6	46.7	77.3
Net book value				
At 31 December 2016	0.1	98.4	30.8	129.3

19. Property, plant and equipment continued...

	Construction in progress £m	Land and buildings £m	Equipment fixtures, fittings and vehicles £m	Total £m
Society				
Cost				
At 1 January 2017	**0.1**	**122.9**	**77.4**	**200.4**
Additions	**–**	**2.5**	**3.2**	**5.7**
Disposals	**–**	**(7.3)**	**(5.3)**	**(12.6)**
Transfers	**(0.1)**	**0.1**	**–**	**–**
At 31 December 2017	**–**	**118.2**	**75.3**	**193.5**
Depreciation				
At 1 January 2017	**–**	**25.1**	**46.4**	**71.5**
Charged in year	**–**	**6.0**	**8.6**	**14.6**
Impairment	**–**	**1.8**	**0.6**	**2.4**
Disposals	**–**	**(3.5)**	**(4.3)**	**(7.8)**
Transfers	**–**	**–**	**–**	**–**
At 31 December 2017	**–**	**29.4**	**51.3**	**80.7**
Net book value				
At 31 December 2017	**–**	**88.8**	**24.0**	**112.8**
Cost				
At 1 January 2016	0.6	132.7	77.1	210.4
Additions	3.5	3.0	5.3	11.8
Disposals	–	(14.9)	(6.3)	(21.2)
Transfers	(4.0)	2.1	1.3	(0.6)
At 31 December 2016	0.1	122.9	77.4	200.4
Depreciation				
At 1 January 2016	–	29.9	43.0	72.9
Charged in year	–	4.1	9.4	13.5
Impairment	–	–	–	–
Disposals	–	(8.8)	(6.0)	(14.8)
Transfers	–	(0.1)	–	(0.1)
At 31 December 2016	–	25.1	46.4	71.5
Net book value				
At 31 December 2016	0.1	97.8	31.0	128.9

Notes to the Accounts continued...

19. Property, plant and equipment continued...

The carrying values of property, plant and equipment are reviewed for impairment where there is an indication that events or circumstances may mean that the carrying amount is not recoverable. Where the recoverable amount of the asset is estimated to be less than the carrying amount, the carrying amount is written down immediately to the recoverable amount. Any impairment in the value of assets is dealt with through the Income Statement as it arises.

20. Deferred tax assets and liabilities

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
The movement on the net deferred tax asset is as follows:				
At 1 January	**0.1**	9.6	**(3.5)**	9.9
Income Statement (charge)/credit (Note 11)	**(0.7)**	1.3	**1.9**	(2.6)
Tax expense recognised directly in equity	**(20.3)**	(10.8)	**(20.3)**	(10.8)
At 31 December	**(20.9)**	0.1	**(21.9)**	(3.5)
Deferred tax assets and liabilities are attributable to the following items:				
Deferred tax assets				
Other temporary differences	**2.1**	1.2	**1.3**	1.2
Depreciation in excess of capital allowances	**3.0**	2.2	**3.0**	2.2
Transfer of engagements – tax value of losses carried forward	**–**	2.3	**–**	2.3
Pensions and other post retirement benefits	**–**	0.8	**–**	0.8
Implementation of IAS 39 – mortgages and hedging	**0.6**	0.9	**0.6**	0.9
Cash flow hedging	**1.2**	2.7	**1.2**	2.7
Transfer of engagements – fair value adjustments	**–**	2.2	**–**	2.2
Fair value volatility on financial instruments in securitisation entities	**0.6**	4.0	**–**	–
Restructuring costs	**1.2**	–	**1.2**	–
	8.7	16.3	**7.3**	12.3
Deferred tax liabilities				
Pensions and other post retirement benefits	**23.8**	10.5	**23.8**	10.5
Other temporary differences	**1.5**	1.8	**1.5**	1.7
Transfer of engagements – fair value adjustments	**0.3**	0.4	**0.3**	0.4
Fair value volatility on financial instruments in securitisation entities	**0.4**	0.3	**–**	–
Available for sale securities	**3.6**	3.2	**3.6**	3.2
	29.6	16.2	**29.2**	15.8

20. Deferred tax assets and liabilities continued...

The deferred tax assets have not been discounted. The Group considers that sufficient future taxable trading profits will be available to utilise the Group's trading deferred tax assets and the Group has therefore recognised such deferred tax assets where they have arisen.

The deferred tax charge/(credit) in the Income Statement comprise the following temporary differences:

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Accelerated tax depreciation	**(0.8)**	0.4	**(0.8)**	0.4
Pensions and other post-retirement benefits	**(0.1)**	0.2	**(0.1)**	0.2
Other temporary differences	**0.1**	2.1	**0.1**	2.0
Fair value volatility on financial instruments in securitisation entities	**2.6**	(4.0)	**–**	–
Restructuring costs	**(1.1)**	–	**(1.1)**	–
	0.7	(1.3)	**(1.9)**	2.6

21. Other assets

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Prepayments and accrued income	**18.1**	18.0	**18.1**	18.0
Due from subsidiary undertakings	**–**	–	**10.9**	13.0
Other assets	**12.3**	10.8	**10.7**	8.6
	30.4	28.8	**39.7**	39.6

22. Shares

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Shares comprising balances held by individuals	**28,985.1**	28,757.2	**28,985.1**	28,757.2
Fair value adjustments	**(47.1)**	(64.0)	**(47.1)**	(64.0)
	28,938.0	28,693.2	**28,938.0**	28,693.2

Notes to the Accounts continued...

23. Amounts owed to credit institutions

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Amounts owed to:				
Banks	**4,451.6**	3,120.8	**4,442.9**	3,111.4
	4,451.6	3,120.8	**4,442.9**	3,111.4

Included within amounts owed to credit institutions are amounts deposited by counterparties under swap collateralisation agreements.

24. Other deposits

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Amounts owed to:				
Group companies	**–**	–	**8,332.4**	6,733.8
Other customers	**420.2**	434.7	**135.8**	165.0
	420.2	434.7	**8,468.2**	6,898.8

Amounts due to Group companies comprise balances due to subsidiary undertakings.

25. Debt securities in issue

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Covered bonds	**2,521.1**	2,105.4	**2,521.1**	2,105.4
Medium term notes	**1,671.0**	1,601.4	**1,671.0**	1,601.4
Residential mortgage backed securities	**741.2**	654.6	**–**	–
	4,933.3	4,361.4	**4,192.1**	3,706.8

Debt securities in issue include amounts secured on certain loans and advances to customers – Group £3.3bn (2016: £2.8bn) and Society £2.5bn (2016: £2.1bn).

26. Retirement benefit obligations

The Group operates one main employee benefit scheme (the Scheme), the costs of which are borne by the Society, with both defined benefit and defined contribution sections.

In addition, the Group operates unfunded defined benefit pension schemes for certain current and former members of staff. The present value at 31 December 2017 of the defined benefit obligation in relation to these schemes was £9.6m (2016: £9.8m) and the relevant disclosures have been aggregated with those of the main employee benefits scheme.

26. Retirement benefit obligations continued...

Defined contribution post-employment benefits
In addition to the defined benefit section (see below), the Group operates a defined contribution section of the main scheme. This includes a section which covers auto-enrolled employees. The Group also contributes to the National Employment Savings Trust in respect of its auto-enrolment employees. The total expense recognised for these defined contribution benefits is £18.2m (2016: £17.1m).

Defined benefit post-employment benefits
The Group operates a funded defined benefit scheme for certain employees, providing benefits based on final salary. Benefits earned by members of the defined benefit section of the main scheme from 1 April 2010, with the exception of N&P Section members, are based on career average revalued earnings. N&P Section members' benefits are based on their Final Pensionable Salary. The assets of the Scheme are held in a separate trustee-administered fund. Contributions 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 employees in 2000 and to future accrual on 31 December 2015.

The Scheme is governed under the Scheme's current Trust Deed and Rules dated 1 April 2010 and subsequent Deeds of Amendment and Merger Deeds. The Trustees are responsible for the operation and governance of the Scheme, including making decisions regarding the Scheme's funding and investment strategy.

The defined benefit section of the Scheme has a weighted average maturity of around 21 years. This weighted average duration of a pension scheme is the average discounted term until benefit payments are due, weighted by the size of the payment.

A breakdown of the scheme liabilities by members is included below.

	31 Dec 2017 £m
Actives	**193.6**
Deferreds	**266.5**
Pensioners	**439.0**
Total liabilities	**899.1**

Summary of assumptions	**31 Dec 2017 %**	31 Dec 2016 %
Retail Prices Index (RPI) Inflation	**3.4**	3.5
Consumer Price Index (CPI) inflation	**2.4**	2.5
Discount rate	**2.4**	2.6
Rate of increase in pay	**3.7**	4.5
Rate of increase of pensions in payment*		
in line with RPI, subject to a min of 3% and a max of 5% pa	**3.8**	3.9
in line with RPI, subject to a min of 0% and a max of 5% pa	**3.1**	3.2
in line with RPI, subject to a min of 0% and a max of 2.5% pa	**2.0**	2.0
in line with CPI, subject to a min of 0% and a max of 3% pa	**2.0**	2.1
Rate of increase for deferred pensions*		
in line with CPI, subject to a min of 0% and a max of 5% pa	**2.4**	2.5
in line with CPI, subject to a min of 0% and a max of 2.5% pa	**2.4**	2.5

*In excess of any Guaranteed Minimum Pension (GMP) element.

The demographic assumptions adopted for accounting purposes have been set in line with the Technical Provisions basis including a movement in rate of increase in pay assumption from RPI plus 1.0% to CPI plus 1.25% which reflects the Society's views of long-term future inflation, based on past experience and future expectations.

Notes to the Accounts continued...

26. Retirement benefit obligations continued...

The most significant non-financial assumption is the assumed rate of longevity. The assumptions made are equivalent to the following life expectancies for scheme members at age 60:

	2017 Years	2016 Years
For a current 60 year old male	**28.6**	28.6
For a current 60 year old female	**29.9**	29.2
For a current 45 year old male	**30.0**	30.4
For a current 45 year old female	**31.3**	31.1

Reconciliation of funded status	31 Dec 2017 £m	31 Dec 2016 £m
Present value of defined benefit obligation	**(899.1)**	(949.3)
Assets at fair value	**994.3**	991.3
Funded status/defined benefit asset	**95.2**	42.0

Statement of Comprehensive Income (SCI)	2017 £m	2016 £m
Cumulative actuarial gains recognised at 1 January	**(8.3)**	18.7
Loss on change of financial assumptions	**(6.6)**	(220.0)
Loss on change of demographic assumptions	**(3.1)**	–
Experience adjustments	**40.4**	6.3
Return on plan assets greater than discount rate	**19.1**	186.7
Total actuarial gain/(loss) recognised in SCI	**49.8**	(27.0)
Cumulative actuarial gains/(losses) recognised at 31 December	**41.5**	(8.3)

Components of pension expense as shown in the Income Statement	2017 £m	2016 £m
Service cost	**–**	–
Administrative expenses	**1.7**	1.5
Interest on net defined benefit surplus	**(1.0)**	(2.4)
Total pension expense	**0.7**	(0.9)

Service cost is the Group's cost, net of employee contributions and inclusive of interest to the reporting date.

26. Retirement benefit obligations continued...

Reconciliation of present value of defined benefit obligation	2017 £m	2016 £m
Present value of defined benefit obligation at 1 January	**949.3**	735.2
Defined benefit service cost	**–**	–
Administrative expenses	**1.7**	1.5
Interest cost	**23.8**	27.2
Actuarial (loss)/gain	**(30.7)**	214.5
Defined benefit actual benefits paid	**(45.0)**	(29.1)
Present value of defined benefit obligation at 31 December	**899.1**	949.3

Movement in defined benefit fair value of assets	2017 £m	2016 £m
Fair value of assets at 1 January	**991.3**	796.9
Interest income on scheme assets	**24.8**	29.6
Actuarial gain on assets	**19.1**	186.7
Defined benefit actual Society contributions	**4.0**	6.9
Defined benefit actual benefits and costs paid	**(44.9)**	(28.8)
Fair value of plan assets at 31 December	**994.3**	991.3

The £40.4m experience gain comprises a £5.7m gain due to pension increases, deferred revaluation and Career Average Revalued Earning ('CARE') revaluation being lower than assumed and a £34.7m gain due to allowing for the results of the 31 December 2016 actuarial valuation. In particular, there were a higher number of in-service deferred members who became deferred than had been assumed therefore breaking the salary link.

Defined benefit actual contributions paid wholly relate to contributions made by the Society. Society contributions include deficit contributions of £4.0m (2016: £6.4m). Expected contributions for the period ending 31 December 2018 are £2.5m. None of the assets were invested in the Group's own financial instruments (2016: £nil) or the Group's own property (2016: £nil).

Scheme specific risks
The ultimate cost of the Scheme to the Society will depend upon actual future events rather than the assumptions made. Many of the assumptions made are unlikely to be borne out in practice and, as such, the cost of the schemes may be higher or lower than disclosed. In general, the risk to the Society is that the assumptions underlying the disclosures, or the calculation of contribution requirements, are not borne out in practice and the cost to the Society is higher than expected. This could result in higher contributions being required from the Society and a higher deficit being disclosed. This may also impact the Society's ability to grant discretionary benefits or other enhancements to members.

The assumptions not being borne out in practice could include:

i. The investment return on the Scheme's assets being lower than assumed, resulting in an unaffordable increase in the contributions required from the Society. The level of bond returns will be a key determinant of overall investment return; the investment portfolio is also subject to a range of other risks typical of the asset classes held, in particular equity returns, credit risk on bonds and exposure to the property market.

ii. Falls in asset values (particularly equities) not being matched by similar falls in the value of liabilities. This risk has been mitigated to some degree by the implementation of an asset liability matching investment strategy which is designed to match a proportion of the Scheme's interest rate exposure.

Notes to the Accounts continued...

26. Retirement benefit obligations continued...

iii. Future levels of inflation being higher than assumed, resulting in higher than anticipated annual increases to benefits in payment, revaluations of benefits prior to retirement and salary increases. This risk has been mitigated to some degree by the implementation of an asset liability matching investment strategy which is designed to match a proportion of the Scheme's inflation exposure.

iv. Unanticipated improvements in the longevity of members leading to an increase in the Scheme's liabilities.

Assets
The Scheme's investment strategy, with a significant proportion of the assets invested in an asset liability matching strategy (consisting of index-linked government and corporate bonds and swaps), is expected to reduce the volatility of the difference between the market value of the assets and the IAS 19 liabilities (at the date of implementation in October 2012, the strategy hedged around 70% of the Scheme's interest rate and inflation rate risk).

Disaggregation of assets	**31 Dec 2017 %**	31 Dec 2016 %
Equities	**15**	13
Index-linked bonds	**58**	61
Corporate and other bonds	**8**	8
Cash and other	**7**	7
Swaps	**12**	11
	100	100

The majority of the Scheme's investments are in quoted assets, with the exception of the liability matching assets classified as 'Swaps' and reinsurance assets included in 'Cash and other', where a proportion of these will be invested in unquoted assets.

Scheme investment strategy
The Scheme's investment strategy seeks to reduce investment risk over time, within an agreed 'journey plan' that anticipates a managed transition to assets that carry lower risk albeit with expectations of lower investment returns. This transition will occur when the funding level meets pre-agreed de-risking levels.

The investment objective of the Defined Benefit ('DB') Section is to maintain a portfolio of suitable assets of appropriate liquidity which will generate investment returns to meet, together with future contributions, the benefits of the DB Section payable under the Trust Deed and Rules as they fall due.

The Trustees set the investment strategy for the DB Section taking into account considerations such as the strength of the employer covenant, the long-term liabilities of the DB Section and the funding agreed with the Employer. The investment strategy is set out in its Statement of Investment Principles (SIP).

The current strategy is to hold:

- 62.25% in investments that move in line with the long-term liabilities of the Scheme. This is referred to as Liability Driven Investment ("LDI") and comprises UK Government and Network Rail bonds and interest rate and Retail Price Index ("RPI") swaps, the purpose of which is to hedge against the impact of interest rate movement on approximately 85% of the long-term liabilities.
- 37.75% in return seeking investments comprising UK and Emerging Market equities, UK and global corporate bonds, global Real Estate Investment Trusts ("REITs"), Emerging Market debt and global reinsurance.

31 December 2016 actuarial valuation
The most recent actuarial valuation of the Scheme was carried out with an effective date of 31 December 2016 and was completed on 31 July 2017. The value of the benefits promised to members that fall within the DB section of the Scheme are referred to as the Technical Provisions, and are valued on a prudent basis as determined by the Trustees, having received advice from the Scheme Actuary.

26. Retirement benefit obligations continued...

The funding level (the ratio of assets to Technical Provisions) at 31 December 2016 was 99.1%. A Recovery Plan was agreed between the Society and the Trustees in order to make good this shortfall. It was agreed that the Society would pay £2.5 million pa over 2018 and 2019, subject to transfer experience, to eliminate the deficit, which is anticipated to be eliminated by 31 December 2019.

The key difference in the economic assumptions is the discount rate. The discount rate used in calculating the Technical Provisions must be prudent and reflect the Trustees' long-term investment strategy. This has been set to be in line with gilt yields, plus a margin of 0.5% pa. The discount rate used in calculating the DB obligation for accounting purposes is prescribed by IAS19 and must be set with regard to the yield available on high quality corporate bonds. In general, this results in a higher discount rate for the calculation of the DB obligation. Looking specifically at the valuation date, 31 December 2016, the discount rate on the Technical Provisions basis, of 2.25% pa, compared to a discount rate on the accounting basis, at the same date, of 2.55% pa.

The demographic assumptions adopted for accounting purposes have been set in line with the Technical Provisions basis including a movement in rate of increase in pay assumption from RPI plus 1.0% to CPI plus 1.25%. The one exception to this is that the Technical Provision basis makes an allowance for GMP equalisation, whereas no allowance has been made within the accounting figures.

Sensitivities
The IAS19 liability measurement and the service cost are sensitive to the assumptions made about future inflation and salary growth levels, as well as the assumptions made about life expectation. They are also sensitive to the discount rate, which depends on market yields on Sterling-denominated high quality corporate bonds. A decrease in corporate bond yields will increase the liabilities although this will be partially offset by an increase in matching assets.

The table below shows the sensitivity of the defined benefit obligation and Scheme assets to changes in these assumptions. The final assumptions are chosen by the Society.

Principal Sensitivity Illustrations	Defined benefit obligation £m	Assets £m	Net effect £m
Total as at 31 December 2017	(899.1)	994.3	**95.2**
Change in defined benefit obligation/assets given the following change of assumption:			
Discount Rate[1]: 1.00% decrease	(211.6)	232.7	**21.1**
Salary Escalation: 0.75% increase	(10.1)	–	**(10.1)**
Inflation[2]: 0.50% increase	(41.8)	48.3	**6.5**
Life Expectancy: 1 year average increase	(31.5)	–	**(31.5)**

[1] The change in the discount rate is assumed to be equivalent to a 1% decrease in gilt, swap and credit based interest rates.

[2] The sensitivity illustrations above are calculated by changing each assumption in isolation, keeping all other assumptions constant. In practice this is unrealistic as the financial assumptions are correlated.

The asset liability matching strategy implemented for the Scheme means that a change in discount rate or inflation assumption has a broadly similar impact on the liabilities and the assets, reducing the volatility of the net impact.

27. Other liabilities

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Accruals and deferred income	**48.0**	43.5	**45.7**	42.0
Other	**14.5**	11.2	**10.2**	11.0
	62.5	54.7	**55.9**	53.0

Notes to the Accounts continued...

28. Provisions

Movements in provisions during the year were as follows:

Group	FSCS levy £m	Customer redress £m	Restructuring £m	Other £m	Total £m
2017					
At 1 January 2017	**5.2**	**17.9**	**–**	**6.0**	**29.1**
Amounts utilised during the year	**(5.2)**	**(12.7)**	**(4.4)**	**(1.3)**	**(23.6)**
Provision charge during the year	**2.5**	**19.7**	**13.6**	**4.5**	**40.3**
At 31 December 2017	**2.5**	**24.9**	**9.2**	**9.2**	**45.8**
2016					
At 1 January 2016	9.0	7.0	–	9.8	25.8
Amounts utilised during the year	(8.3)	(4.7)	–	(0.7)	(13.7)
Provision charge/(release) during the year	4.5	15.6	–	(3.1)	17.0
At 31 December 2016	5.2	17.9	–	6.0	29.1

Society	FSCS levy £m	Customer redress £m	Restructuring £m	Other £m	Total £m
2017					
At 1 January 2017	**5.2**	**17.8**	**–**	**6.0**	**29.0**
Amounts utilised during the year	**(5.2)**	**(12.6)**	**(4.4)**	**(1.3)**	**(23.5)**
Provision charge during the year	**2.5**	**19.6**	**13.6**	**4.5**	**40.2**
At 31 December 2017	**2.5**	**24.8**	**9.2**	**9.2**	**45.7**
2016					
At 1 January 2016	9.0	7.0	–	9.8	25.8
Amounts utilised during the year	(8.3)	(4.8)	–	(0.7)	(13.8)
Provision charge/(release) during the year	4.5	15.6	–	(3.1)	17.0
At 31 December 2016	5.2	17.8	–	6.0	29.0

28. Provisions continued...

Financial Service Compensation Scheme (FSCS)

The FSCS provides compensation to consumers if a firm is unable to pay claims against it. As a consequence of the default of a number of deposit taking institutions, FSCS took out loans from HM Treasury to compensate their protected deposits. The FSCS levies member firms to recover the interest cost on the loans from HM Treasury and has communicated that the level of the future levies will be reviewed following developments from the failed legacy estates.

The Group has recognised a provision charge for estimated levies due of £2.5m, (2016: £4.5m), for the scheme year 2017/2018, in this year's results. The decrease in the 2017 charge compared with the prior year is due to the sale by UK Asset Resolution Limited of certain mortgage assets relating to the Bradford & Bingley portfolio leading to a significant reduction in the amount borrowed by FSCS from HM Treasury.

Customer remediation and conduct issues

Provisions have been made in respect of various potential customer claims and represent management's best estimate of the likely costs. The largest provision of £21.3m (2016: £9.6m) relates to sales of PPI and is calculated using management's estimate of complaint volumes, referral levels to the FOS, claim rates upheld internally and by FOS, redress payments and complaint handling costs. The increase in the provision in 2017 reflects the FCA's guidance published in its March 2017 policy statement (PS17/03), including the impact from action expected to be taken in response to the Supreme Court ruling on 'Plevin v Paragon Personal Finance Ltd' and the longer time period in which claims can be submitted. The latest estimated costs incorporate the expected impact on future claim volumes as a result of the FCA's PPI media campaign.

A provision of £3.5m (2016: £8.2m) is held in relation to other required customer remediation relating to a small number of specific instances where we made mistakes we needed to rectify. This includes £0.9m of provision for new issues identified during 2017 which are yet to be remediated. We remain committed to identifying and fairly rectifying areas where we have made mistakes.

Restructuring and Other

A restructuring provision of £9.2m (2016: £nil) and onerous lease provision of £8.1m (2016: £4.9m) are held in relation to business and organisational changes announced during 2017 and earlier periods. The majority of the restructuring costs are due to be paid in 2018, whilst the onerous lease provision will be utilised over the remaining term of the unoccupied leasehold branches.

29. Subordinated liabilities

Group and Society	**2017 £m**	2016 £m
Floating Subordinated Bonds 2018	**5.0**	5.0
11⅜% Subordinated Bonds 2022	**–**	5.0
6⅜% Subordinated Bonds 2024	**4.1**	4.1
4⅛% Subordinated Bonds 2024	**250.0**	249.4
13½% Convertible Tier 2 Capital Notes 2025	**26.1**	26.0
3⅜% Subordinated Bonds 2028	**300.0**	–
Fair value hedging adjustments	**8.5**	7.5
	593.7	297.0

Notes to the Accounts continued...

29. Subordinated liabilities continued...

All subordinated liabilities are denominated in Sterling. The following notes are repayable at the dates stated or earlier at the option of the Society and with the prior consent of the PRA under the following conditions:

- The Society exercised its option to repay early the 11⅜% Notes at par on 27 November 2017.
- Redemption of all (but not some only) of the 4⅛% Notes at par on 20 November 2019 after giving not less than 30 nor more than 60 days' notice to the holders. In the event the Society does not redeem the notes on 20 November 2019 the fixed rate of interest will become the sum of the five year Gilt rate and 2.90%.
- Redemption of all (but not some only) of the 3⅜% Notes at par on 13 September 2027 after giving not less than 30 nor more than 60 days' notice to the holders. In the event the Society does not redeem the notes on 13 September 2027 the fixed rate of interest will become the sum of the six month mid-swap rate plus 2.3175%.
- Redemption of all (but not some only) of the 13½% Convertible Tier 2 Capital Notes will occur on 1 April 2025 unless the notes are converted to Profit Participating Deferred Shares (PPDS). The 'Conversion Trigger' shall occur if on any Calculation Date the Society's Common Equity Tier 1 Capital Ratio, as confirmed in a report of the auditor to the Society and addressed to the Board of Directors of the Society, is less than 5%. Should the Conversion Trigger occur on the 13½% Convertible Notes and these notes convert into PPDS, the PPDS will be perpetual in nature, ranking pari passu with the currently issued Subscribed Capital (detailed in Note 30).

The rights of repayment of the holders of subordinated liabilities are subordinated to the claims of all depositors, creditors and members holding shares in the Society, as regards the principal of their shares and interest due on them.

30. Subscribed capital

Group and Society	2017 £m	2016 £m
5.649% Permanent Interest Bearing Shares	**6.1**	6.2
Fair value hedging adjustments	**0.3**	0.5
	6.4	6.7

All Permanent Interest Bearing Shares (PIBS) are unsecured and denominated in Sterling. Interest is payable half yearly on 27 March and 27 September. PIBS are repayable at the option of the Society, in whole, in March 2019 or any interest payment date thereafter.

Repayment requires the prior consent of the PRA. If the PIBS are not repaid on a call date the interest rate is reset at a margin to the then prevailing LIBOR rate. They are deferred shares of the Society and the rights of repayment of the holders of PIBS are subordinated to the claims of all depositors, creditors, members holding shares in the Society and holders of subordinated liabilities, as regards the principal of their shares and interest due on them. The interest rate risk arising from the issuance of fixed rate PIBS has been mitigated through the use of interest rate swaps.

31. Capital management

The ratios, deductions and definitions below are in accordance with CRD IV regulations.

	2017 £m	2016 £m
Tier 1		
Common Equity Tier 1 (CET1)		
General reserve	**2,377.2**	2,215.4
AFS reserve	**10.8**	8.2
Deferred tax assets that rely on future profitability	**–**	(2.3)
Pension fund adjustments[1]	**(71.4)**	(31.5)
Intangible fixed assets[2]	**(31.3)**	(32.9)
Deductions from Tier 1 capital[3]	**(1.6)**	(37.6)
Total Common Equity Tier 1 capital	**2,283.7**	2,119.3
Additional Tier 1 Capital (AT1)		
Subscribed capital[4]	**3.2**	4.0
	2,286.9	2,123.3
Tier 2		
Subordinated liabilities[5]	**589.2**	291.5
Collective allowances for impairment	**24.5**	34.4
	613.7	325.9
Total capital	**2,900.6**	2,449.2
Risk weighted assets	**14,449.4**	14,179.7
Common Equity Tier 1 capital ratio	**15.8%**	14.9%
Tier 1 ratio	**15.8%**	15.0%
Total capital ratio	**20.1%**	17.3%
Leverage ratio[6]	**5.1%**	5.1%
Leverage ratio (excluding claims on central banks)[7]	**5.7%**	5.6%

[1] CRD IV requires a pension fund surplus, net of any associated deferred tax liabilities, to be deducted from Tier 1 capital (CET1). CRD IV does not permit a pension fund deficit to be added back to regulatory capital.

[2] CRD IV requires intangible fixed assets, net of any associated deferred tax liabilities, to be deducted from CET1.

[3] Securitisation positions that are unrated or have low external ratings have been deducted from CET1.

[4] Under CRD IV, subscribed capital is being phased out as qualifying for regulatory Tier 1 capital over a 10 year period. Currently 60% of the subscribed capital balance sheet carrying value qualifies AT1 capital.

[5] Subordinated liabilities with less than five years to maturity are adjusted for amortisation in the regulatory capital value of instruments.

[6] CRD IV regulatory capital rules have introduced a non-risk based leverage requirement that measures the relationship between capital resources and an adjusted measure of total on and off balance sheet assets. A minimum leverage ratio of 3% is in force for the UK's largest institutions until 2017. It will be become mandatory for all other institutions (including the Group) from 2018.

[7] This ratio is based on the calculation as stipulated in PS21/17 increasing the minimum leverage ratio to 3.25% and allowing the exclusion from the calculation of the leverage exposure certain assets. Currently, this calculation applies to the UK's largest institutions; defined as regulated banks and building societies with retail deposits equal to or greater than £50bn; as such, the calculation does not apply to the Group, although this will be reviewed in due course by the PRA.

Notes to the Accounts continued...

31. Capital management continued...

Throughout the year the Prudential Risk Committee has reviewed the Group's capital position and regulatory developments under CRD IV.

For a detailed analysis of the Group's capital position and disclosures please refer to the Pillar 3 Disclosure for 2017 which can be found on our website ybs.co.uk.

32. Financial commitments

Group and Society	**2017 £m**	2016 £m
Committed undrawn standby facilities	**197.8**	217.7

The Society has an obligation under the Building Societies Act 1986 to discharge the liabilities incurred up to 11 June 1996 of all subsidiaries in so far as those subsidiaries are unable to discharge the liabilities out of their own assets. The Society has given undertakings whereby it has agreed to discharge the liabilities incurred after 11 June 1996 by certain subsidiaries, in the event that these subsidiaries may be unable to discharge them out of their own assets. In addition, the Society guarantees certain Accord mortgage buyback obligations regarding the Group's securitisation entities (discussed in Note 35) in the event that Accord may be unable to discharge these obligations.

The Society accounts for these guarantees in accordance with IFRS 4 'Insurance Contracts'.

Capital commitments contracted for at 31 December 2017, but for which no provision has been made in the accounts, amounted to Group £0.5m and Society £0.5m (2016: Group £0.5m and Society £0.5m).

Future minimum lease payments under non-cancellable operating leases are as follows:

	2017		2016	
Group	**Land and buildings £m**	**Other £m**	Land and buildings £m	Other £m
Within one year	**6.7**	**0.4**	6.7	0.4
Between one and five years	**19.3**	**0.5**	19.7	0.9
Over five years	**6.5**	**–**	9.6	–
	32.5	**0.9**	36.0	1.3

The Group leases various offices and branches under non-cancellable operating lease arrangements. These leases have various terms, escalation clauses and renewal rights. The other category relates to lease of IT equipment.

The Group is not in default on any of its financial liabilities or commitments.

33. Financial instruments

The table below summarises the main financial instruments, their significant terms and conditions and the accounting treatment adopted.

Financial instrument	Significant terms and conditions	Accounting treatment
Cash in hand and balances with the Bank of England	Short-term cash balances and statutory deposits Fixed and variable interest rates and non-interest bearing	Amortised cost
Loans and advances to credit institutions	Short-term Fixed and variable interest rates	Amortised cost
Debt securities	Short-term, medium-term and long-term Fixed and variable interest rates	Generally held at fair value as available for sale assets Certain investments are held at fair value through the Income Statement or held to maturity at amortised cost. Detail is given in Note 15
Loans and advances to customers	Loan period is typically up to 25 years Primarily mortgage products offering a variety of fixed and variable interest rates	Amortised cost*
Derivative financial instruments	Primarily medium-term Value derived from underlying price, rate or index	Fair value through profit and loss
Intercompany deposit from Covered Bond Limited Liability Partnerships	Long-term Fixed and variable interest rates	Fair value through profit and loss
Investments	Share and loan investments in subsidiary companies Investments in equities	Cost/Amortised cost Fair value as available for sale
Shares	Deposits made by individuals Varying withdrawal notice periods Fixed and variable interest rates	Amortised cost
Amounts owed to credit institutions	Primarily short-term Time Deposits Fixed and variable interest rates	Amortised cost
Debt securities in issue	Medium-term Fixed and variable interest rates	Amortised cost*
Subordinated liabilities	Long-term Fixed and variable interest rates	Amortised cost*
Subscribed capital	Long-term Fixed interest rates	Amortised cost*

* Except where hedge accounting allows a fair value adjustment to be made for interest rate risk.

Notes to the Accounts continued...

34. Derivative financial instruments

Instruments used for the management of market risk include derivative financial instruments (derivatives) which are contracts or agreements whose value is derived from one or more underlying price, rate or index inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices.

Derivatives are only used by the Group in accordance with the Building Societies Act 1986. This means that such instruments are not used in trading activity or for speculative purposes and are only used to reduce the risk of loss on core assets or liabilities arising from changes in interest rates, currency rates or other factors of a prescribed description.

The principal derivatives used in balance sheet risk management are interest rate swaps, interest rate options, cross-currency interest rate swaps, forward rate agreements, futures contracts and foreign exchange contracts. These are used to hedge Group exposures arising from fixed rate mortgage lending and savings products, funding and investment activities.

The following table describes the significant activities undertaken by the Group, the related risks associated with such activities and the type of derivatives which are typically used in managing such risks. Such risks may alternatively be managed using 'on balance sheet' instruments as part of the Group's integrated approach to risk management.

Activity	Risk	Type of hedge
Management of the investment of reserves and other net non-interest bearing liabilities	Sensitivity to changes in interest rates	Interest rate swaps
Fixed rate savings products and options, forward fixed rate funding	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Fixed rate mortgage lending and options, forward fixed rate investments	Sensitivity to changes in interest rates	Interest rate swaps, forward rate agreements and futures
Management of the interest basis risk arising from differences in the underlying pricing basis of assets and liabilities	Sensitivity to changes in relationships between interest rate bases	Interest rate swaps where one leg is referenced to LIBOR or SONIA and the other to Bank Base Rate
Equity linked investment products	Sensitivity to changes in equity indices	Equity linked interest rate swaps
Investment and funding in rate swaps and foreign currencies	Sensitivity to changes in foreign exchange rates	Cross-currency interest rate swaps and foreign exchange contracts

The Group's objective is to manage risk within its risk tolerance, irrespective of the accounting treatment.

Those derivative products which are combinations of more basic derivatives are used only in circumstances where the underlying position being hedged contains the same risk features. In such cases the derivatives used will be designed to match the risks of the underlying asset or liability and therefore to hedge the associated market risk.

Certain financial instruments (including some retail products) contain features that are similar to derivatives. In the majority of such cases, the Group manages the associated risks by entering into derivative contracts that match these features.

Whilst all derivatives have been entered into for hedging purposes, only certain ones have been designated as such for accounting purposes. In some cases a natural offset can be achieved without applying the requirements of IAS 39. The Group only designates hedges where a high degree of effectiveness can be achieved.

Fair value hedges are designated where interest rate swaps are used to minimise the variability in the fair value of fixed interest financial instruments (mainly fixed rate mortgages).

Cash flow hedges are designated where interest rate swaps are used to convert the interest rate variability on short-term financial instruments into fixed rates.

34. Derivative financial instruments continued...

The following tables summarise the notional and fair value of all derivative financial instruments held at the year end and the hedging designations in place at that date.

	Contract/ notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Group			
At 31 December 2017			
Interest rate swaps designated as fair value hedges	**24,424.0**	**130.6**	**103.9**
Interest rate swaps designated as cash flow hedges	**241.3**	**2.7**	**12.4**
Cross-currency interest rate swaps designated as fair value hedges	**2,972.6**	**420.3**	**–**
Derivatives not designated as hedges:			
Interest rate swaps	**9,117.0**	**12.3**	**40.6**
Equity linked interest rate swaps	**122.5**	**25.8**	**–**
Foreign exchange	**9.5**	**0.1**	**–**
Total derivatives held for hedging	**36,886.9**	**591.8**	**156.9**
Society			
At 31 December 2017			
Interest rate swaps designated as fair value hedges	**32,549.5**	**102.2**	**107.0**
Interest rate swaps designated as cash flow hedges	**241.3**	**2.7**	**12.4**
Cross-currency interest rate swaps designated as fair value hedges	**1,197.9**	**181.0**	**–**
Derivatives not designated as hedges:			
Interest rate swaps	**9,117.0**	**12.3**	**40.6**
Equity linked interest rate swaps	**122.5**	**25.8**	**–**
Foreign exchange	**9.5**	**0.1**	**–**
Total derivatives held for hedging	**43,237.7**	**324.1**	**160.0**

The Society table above includes transactions between Group subsidiaries which are eliminated in the Group accounts.

For collateralised derivatives, the expected future cash flows have been discounted using the Overnight Indexed Swap (OIS) curve, and for non-collateralised derivatives the LIBOR curve has been used for discounting. Credit Valuation Adjustments (CVA) and Debit Valuation Adjustments (DVA) are incorporated into the fair value of derivative valuations to reflect the impact of counterparty credit risk and the Group's own credit quality respectively for uncollateralised derivatives.

Notes to the Accounts continued...

34. Derivative financial instruments continued...

Credit risk on derivative exposures is significantly mitigated within the Group by the existence of a Credit Support Annex (CSA) with the vast majority of our derivative counterparties. Under a CSA, cash is passed between parties to mitigate the counterparty risk inherent in the outstanding positions. Where cash collateral is received, to mitigate the risk inherent in amounts due to the Group, it is included as a liability within amounts owed to credit institutions. Where cash collateral is given to mitigate the risk inherent in amounts due from the Group, it is included as an asset in loans and advances to credit institutions. Credit risk is also mitigated by the use of central counterparties (CCPs) for eligible derivatives.

	Contract/ notional amount £m	Fair values Assets £m	Fair values Liabilities £m
Group			
At 31 December 2016			
Interest rate swaps designated as fair value hedges	22,476.7	136.5	281.7
Interest rate swaps designated as cash flow hedges	350.2	4.7	26.2
Cross-currency interest rate swaps designated as fair value hedges	2,434.6	343.9	–
Derivatives not designated as hedges:			
Interest rate swaps	5,450.6	23.4	39.1
Equity linked interest rate swaps	179.1	32.0	–
Foreign exchange	48.6	–	1.0
Total derivatives held for hedging	30,939.8	540.5	348.0
Society			
At 31 December 2016			
Interest rate swaps designated as fair value hedges	26,710.8	86.4	285.5
Interest rate swaps designated as cash flow hedges	350.2	4.7	26.2
Cross-currency interest rate swaps designated as fair value hedges	1,153.2	156.9	–
Derivatives not designated as hedges:			
Interest rate swaps	5,450.6	23.4	39.1
Equity linked interest rate swaps	179.1	32.0	–
Foreign exchange	48.6	–	1.0
Total derivatives held for hedging	33,892.5	303.4	351.8

34. Derivative financial instruments continued...

Cash Flow Hedging

The Group applies cash flow hedge accounting to a portfolio of interest rate swaps which are economically hedging either floating rate assets, floating rate liabilities or highly probable forecast issuance of debt. During 2017 the following amounts were recorded in relation to cash flow hedge relationships:

- £2.2m profit recognised in the cash flow hedge reserve related to the effective portion of active cash flow hedge relationships that will be recycled to the Income Statement over the life of the hedged item.
- £0.9m loss recorded directly in the Income Statement for the ineffective portion of the hedge relationships.
- £3.8m loss recycled from the cash flow hedge reserve into the Income Statement for hedge transactions that occurred during the year.

The following table shows the maturity profile of the nominal cash flows designated as hedged items:

	Repayable up to three years £m	In more than three years but not more than five years £m	In more than five years but not more than 10 years £m	Total £m
Group				
As at 31 December 2017				
Forecast receivable cash flows	**0.2**	**0.1**	**20.2**	**20.5**
Forecast payable cash flows	**151.8**	**6.4**	**65.8**	**224.0**
Total cash flows	**152.0**	**6.5**	**86.0**	**244.5**

	Repayable up to three years £m	In more than three years but not more than five years £m	In more than five years but not more than 10 years £m	Total £m
Group				
As at 31 December 2016				
Forecast receivable cash flows	20.6	0.2	20.4	41.2
Forecast payable cash flows	3.7	206.8	106.2	316.7
Total cash flows	24.3	207.0	126.6	357.9

Notes to the Accounts continued...

35. Liquidity risk

Liquidity risk is an intrinsic part of the Group's business as long-term mortgages are funded by short-term retail customer balances. Most mortgages have a contractual maturity date of around 25 years but in practice are frequently repaid early; currently the estimated average life of a mortgage is approximately five years. Conversely, experience shows that retail deposits, nominally repayable on demand or with short notice periods, actually remain with the Society for relatively long periods. It is this inherent mismatch in the maturity profiles of retail assets and liabilities that creates liquidity risk.

The Group's liquidity management policy is designed to ensure the maintenance of adequate investments in liquid assets to cover statutory, regulatory and operational requirements. The primary function of liquidity is the provision of sufficient assets in realisable form to ensure the Group is able to meet its liabilities as they arise and to absorb potential cash flow requirements created by the maturity mismatches referred to above or by a liquidity stress scenario.

The Group's liquidity management comprises the following key areas:

- At the highest level, the Group manages its liquidity levels to ensure compliance with the Overall Liquidity Adequacy Rule, as set out by the PRA in Chapter 2 of the Internal Liquidity Adequacy Assessment part of the PRA Rulebook (ILAA rules).
- Limits are established by the Board that govern the quantity, quality and marketability of and returns from the Group's portfolio of liquidity investments. The portfolio is managed by the Treasury function, monitored by the first and second line risk functions and overseen by the Asset and Liability Committee (ALCO) under a series of delegated authorities.
- The Group conducts a series of daily stress tests that are designed to ensure that its liquidity is sufficient to meet its cash flow needs under any one of a number of adverse scenarios should they arise. The scenarios include ones caused by both Group specific and general market events, and incorporate both severe retail savings outflows and the unavailability of wholesale funding. They are constructed on various timescales as far out as three months. These scenarios are updated and approved by the Board annually through the ILAAP.
- The Group also manages liquidity in line with prevailing regulatory requirements, which has been the Liquidity Coverage Ratio (LCR) as prescribed under the European Capital Requirements Directive IV (CRD IV) as part of the Capital Requirements Regulation (CRR) element, since 1 October 2015. The LCR measures the quantity of High Quality Liquid Assets (HQLA) against net liquidity outflows over a 30 day period. YBS currently reports to the PRA on a monthly basis at a Group and Society-only level, with the lower of the two being reported as 165.02% for December 2017 month end. For comparison, the lowest as at 31 December 2016 was 159.91%.
- The Group has also implemented internal backstop limits for liquidity, to mitigate the potential risk of liquidity levels under a risk-based approach being able to be reduced to below what is considered a minimum appropriate level for the Group. These are linked to balance sheet size, and also take account of sources of contingent liquidity, including the ability of the Group to access funding through the various Bank of England facilities.
- The liquidity position of the Group is forecast across the next two years and measured against forecasts of the requirements on both a regulatory and internal basis. This is to ensure that the short-term plans of the Group do not lead to liquidity limits being breached and the financial sustainability of the organisation being threatened.

The above metrics are the key elements of the suite of measures by which the Group actively seeks to manage its liquidity position, along with other complementary metrics which are included within the Group's risk appetite framework.

Liquidity risk in subsidiary companies, with the exception of other deposits, is mitigated by the use of appropriate intercompany loans and deposits.

35. Liquidity risk continued...

Pledged assets

The Group's asset backed funding programmes, reported within debt securities in issue (see Note 25) are secured against certain loans and advances to customers.

In addition, as part of its liquidity management, the Group enters into sale and repurchase agreements whereby the Group sells but agrees to repurchase assets at a future date. Typically this is for up to three months and for UK government securities and listed transferable debt securities. Proceeds of these sale and repurchase agreements are included within amounts owed to credit institutions (see Note 23).

Assets pledged are as follows:

2017	**Carrying amounts of encumbered assets £m**	**Carrying amounts of unencumbered assets £m**	**Total £m**
Liquid assets	**1,563.5**	**4,532.2**	**6,095.7**
Loans and advances to customers	**8,577.5**	**26,483.7**	**35,061.2**
Other assets	**–**	**890.3**	**890.3**
Total assets	**10,141.0**	**31,906.2**	**42,047.2**

2016	Carrying amounts of encumbered assets £m	Carrying amounts of unencumbered assets £m	Total £m
Liquid assets	771.4	3,904.5	4,675.9
Loans and advances to customers	7,644.0	26,459.3	34,103.3
Other assets	–	816.3	816.3
Total assets	8,415.4	31,180.1	39,595.5

All of the assets pledged as security are shown in the Statement of Financial Position as the Group has retained substantially all the risk and rewards of ownership.

The Society established Yorkshire Building Society Covered Bonds LLP in November 2006. The LLP provides security for issues of covered bonds made by the Society to external counterparties. As at 31 December 2017 the Society had in issue £750m and €2,000m of covered bonds.

The Group established its first securitisation programme in 2011. This year the latest securitisation structure, Brass No.6 PLC was established and in October 2017 issued £2,300m of listed debt securities secured against certain loans of Accord Mortgages Ltd. Of these debt securities, £2,000m were retained by the Group to be used as collateral for use in sale and repurchase agreements or central bank operations. As at 31 December 2017, the Group had in issue £5,858m of securitisation notes, of which £5,117m were retained.

Whole mortgage loan pools are pre-positioned at the Bank of England under the Funding for Lending Scheme (FLS) and the Term Funding Scheme (TFS). The whole loan pool is pledged and drawings are made directly against the eligible collateral. However, values shown are the whole mortgage loan pool balances.

Notes to the Accounts continued...

35. Liquidity risk continued...

The tables below show contractual future cash flows for all financial liabilities including interest payments. Further details of liquidity management are contained within the Risk Management Report on pages 61 to 69.

	Repayable on demand and up to three months £m	In more than three months but not more than one year £m	In more than one year but not more than five years £m	Over five years £m	Total £m
Group					
As at 31 December 2017					
Shares	**18,517.4**	**6,965.3**	**3,568.4**	**1.6**	**29,052.7**
Amounts owed to credit institutions	**1,727.5**	**961.3**	**1,768.5**	**–**	**4,457.3**
Other deposits					
Society	**134.1**	**0.4**	**–**	**–**	**134.5**
Subsidiaries	**284.1**	**–**	**–**	**–**	**284.1**
Debt securities in issue	**21.8**	**917.7**	**3,337.6**	**901.3**	**5,178.4**
Subordinated liabilities	**–**	**29.2**	**96.6**	**670.0**	**795.8**
Subscribed capital*	**0.2**	**0.2**	**1.4**	**1.7**	**3.5**
Operating lease payments	**0.2**	**6.5**	**19.8**	**6.5**	**33.0**
Derivative financial liabilities	**28.6**	**54.1**	**103.1**	**11.6**	**197.4**
Total	**20,713.9**	**8,934.7**	**8,895.4**	**1,592.7**	**40,136.7**
Group					
As at 31 December 2016					
Shares	21,790.8	3,983.4	3,096.2	2.9	28,873.3
Amounts owed to credit institutions	802.5	2,131.4	149.1	–	3,083.0
Other deposits					
Society	159.6	3.4	2.0	–	165.0
Subsidiaries	270.0	–	–	–	270.0
Debt securities in issue	20.4	64.7	2,974.3	1,549.0	4,608.4
Subordinated liabilities	–	14.6	63.4	328.8	406.8
Subscribed capital*	0.2	0.2	1.4	1.7	3.5
Operating lease payments	1.8	5.4	20.6	9.6	37.4
Derivative financial liabilities	40.1	99.3	257.7	71.2	468.3
Total	23,085.4	6,302.4	6,564.7	1,963.2	37,915.7

* The table includes interest payments on subscribed capital for 10 years.

35. Liquidity risk continued...

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.

	Repayable on demand £m	Less than three months £m	In more than three months but not more than one year £m	In more than one year but not more than five years £m	Over five years £m	Total £m
Group						
As at 31 December 2017						
Financial assets						
Cash in hand and balances with the Bank of England	**4,893.9**	**–**	**–**	**–**	**–**	**4,893.9**
Loans and advances to credit institutions	**351.0**	**–**	**–**	**–**	**–**	**351.0**
Debt securities	**–**	**–**	**–**	**40.3**	**810.5**	**850.8**
Loans and advances to customers	**1.0**	**218.8**	**112.8**	**1,057.9**	**33,670.7**	**35,061.2**
Derivative financial instruments	**–**	**3.2**	**55.1**	**503.2**	**30.3**	**591.8**
Total financial assets	**5,245.9**	**222.0**	**167.9**	**1,601.4**	**34,511.5**	**41,748.7**
Financial liabilities						
Shares	**16,815.3**	**1,694.6**	**6,904.5**	**3,522.1**	**1.5**	**28,938.0**
Amounts owed to credit institutions	**199.1**	**1,532.3**	**977.6**	**1,742.6**	**–**	**4,451.6**
Other deposits	**329.1**	**88.7**	**2.4**	**–**	**–**	**420.2**
Debt securities in issue	**–**	**–**	**880.1**	**3,206.5**	**846.7**	**4,933.3**
Derivative financial liabilities	**–**	**8.5**	**21.9**	**93.7**	**32.8**	**156.9**
Subordinated liabilities	**–**	**–**	**5.0**	**–**	**588.7**	**593.7**
Subscribed capital	**–**	**–**	**–**	**–**	**6.4**	**6.4**
Total financial liabilities	**17,343.5**	**3,324.1**	**8,791.5**	**8,564.9**	**1,476.1**	**39,500.1**

Notes to the Accounts continued...

35. Liquidity risk continued...

	Repayable on demand £m	Less than three months £m	In more than three months but not more than one year £m	In more than one year but not more than five years £m	Over five years £m	Total £m
Group						
As at 31 December 2016						
Financial assets						
Cash in hand and balances with the Bank of England	3,525.0	–	–	–	–	3,525.0
Loans and advances to credit institutions	542.8	–	–	–	–	542.8
Debt securities	–	24.3	12.2	157.5	414.1	608.1
Loans and advances to customers	–	136.9	104.2	1,086.3	32,775.9	34,103.3
Derivative financial instruments	–	1.8	14.2	505.6	18.9	540.5
Total financial assets	4,067.8	163.0	130.6	1,749.4	33,208.9	39,319.7
Financial liabilities						
Shares	20,262.9	1,465.7	3,880.5	3,082.6	1.5	28,693.2
Amounts owed to credit institutions	186.0	616.3	2,179.5	139.0	–	3,120.8
Other deposits	429.3	0.1	3.3	2.0	–	434.7
Debt securities in issue	–	–	–	2,865.2	1,496.2	4,361.4
Derivative financial liabilities	–	6.3	24.8	285.6	31.3	348.0
Subordinated liabilities	–	–	–	5.0	292.0	297.0
Subscribed capital	–	–	–	–	6.7	6.7
Total financial liabilities	20,878.2	2,088.4	6,088.1	6,379.4	1,827.7	37,261.8

36. Market risk

Market risk is the risk to earnings and capital arising from changes in interest rates, foreign currency exchange rates, structural mismatches within the Statements of Financial Position and the price of financial instruments.

Value at Risk (VaR)

VaR is a risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence. The model used is based on a 10 day holding period and a 99% confidence level.

The VaR model calculates potential movements in market prices by reference to market data from the last 252 days and incorporates underlying risk factors based on historic interest rate volatilities and correlations.

VaR for the Treasury portfolios is calculated and reported on a daily basis and for the Group on a monthly basis. A back test of the VaR model is performed to test the validity of the assumptions and parameters within the model.

A number of limitations should be considered in relation to the VaR model:

1. Historic data is not necessarily a good guide to future events.
2. The model, by definition, does not capture potential losses outside the 99% confidence level, i.e. those events that are extreme in nature.
3. VaR is calculated on the basis of exposures outstanding at the close of business and, therefore, does not necessarily reflect intra-day exposures.

VaR measures below are based upon Treasury positions.

Structural risk analysis (basis risk)

An analysis of interest bearing items by rate type is performed to illustrate key areas of structural mismatch. It identifies mismatches between administered rates, fixed rates and other rates including those linked to Bank Base Rate, SONIA and LIBOR. The effect of LIBOR and SONIA mismatches within the Balance Sheet is measured as the impact on net interest income (for a 12 month rolling period) of an isolated increase in LIBOR/SONIA of one basis point (0.01%). A one basis sensitivity measure is an industry standard approach to quantify the quantum and direction of the interest rate exposure within the Group.

Basis Point value (BP) sensitivity

These measures calculate the change in value of the assets and liabilities resulting from both a one basis point (PV01) and 200 basis points (PV200) parallel upward shift in interest rates. Within the Treasury portfolio this is calculated and reported on a daily basis separately for each currency and at the full Statement of Financial Position level on a monthly basis.

Repricing gap analysis

Repricing dates are analysed primarily to avoid repricing risk concentrations, i.e. the situation where too great a proportion of the Group's assets and liabilities see the interest rates earned or charged on them resetting within a given time period. The aim is to prevent excessive volatility in the net interest margin that could arise if rates shifted adversely within a given time period, and since the Group cannot dictate interest rate movements themselves, the best approach is to limit the amount of assets or liabilities that are exposed in this way. The analysis identifies the net asset/liability repricing position across a series of time intervals. Positions are calculated using nominal amounts and exclude interest flows. General reserves, fixed assets and other liabilities are classified as having 'non-specific' repricing characteristics with a zero rate of interest. The measure is calculated as a reverse cumulative gap.

Notes to the Accounts continued...

36. Market risk continued...

All market risk is managed in the Society on behalf of the Group, hence the tables below apply to the Group.

2017	Year end £000	Average £000	Maximum £000	Minimum £000
LIBOR basis	**7**	**57**	**89**	**7**
SONIA basis	**1,286**	**1,378**	**1,446**	**1,286**
PV01 sensitivity	**(170)**	**(169)**	**(4)**	**(339)**
PV200 sensitivity	**(32,295)**	**(31,617)**	**(85)**	**(63,889)**
Treasury VaR	**5,112**	**10,159**	**19,645**	**4,493**

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	**1,440**	**(23)**	**4**

2016	Year end £000	Average £000	Maximum £000	Minimum £000
LIBOR basis	28	76	326	10
SONIA basis	1,296	1,067	1,296	746
PV01 sensitivity	(279)	(160)	16	(279)
PV200 sensitivity	(53,108)	(30,870)	2,725	(53,108)
Treasury VaR	9,488	3,729	12,476	210

	Greater than one year £m	Greater than five years £m	Greater than 10 years £m
Repricing gap	916	116	2

Detail of how the Group manages its interest rate risk is included in the Risk Management Report on pages 64 to 69.

37. Currency Risk

Currency exchange risk is monitored daily and the Group seeks to minimise its net exposure to assets and liabilities denominated in currencies other than Sterling. Maximum positions throughout the year represented less than 0.01% of total assets.
Actual exposures were:

	2017 £m	2016 £m
Year end	**0.6**	0.4
Maximum	**1.4**	2.4

38. Wholesale credit risk

The Group's wholesale credit risk arises principally from assets held for liquidity purposes. The risk is that counterparties with whom the Group invests liquid assets fail to repay those investments when they fall due. The Group, through the Treasury function, undertakes its own internal rating of all its counterparties and sets individual limits accordingly. These limits are regularly reviewed internally and against the external rating agencies, with revocation or suspension taking place where considered appropriate.

Limits are in place governing the types of instrument in which the Group will invest, as well as geographic limits designed to prevent over-exposure to a given country.

The Group uses an internal credit ratings process to identify potential risks and wholesale related credit risks are reported and discussed monthly at the Prudential Risk Committee.

Whilst recognising that exposures will be maintained across a spectrum of counterparties the Board has maintained a low risk appetite for wholesale credit risk resulting in our inter-bank exposures being limited to operational requirements. A diversified range of counterparties is in place to meet business and regulatory requirements with no credit risk exposures being undertaken by Treasury to counterparties that have not been through an internal approvals process including a formal second LoD function.

The following tables break down Wholesale Group exposures[1] by type using the composite external ratings[2] complying with IFRS 7.

2017	**Aaa-Aa3 £m**	**A1-A3 £m**	**Baa1-Baa3 £m**	**Ba1-B3 £m**	**Caa1-C3 £m**	**Unrated £m**	**Total £m**
Central Bank and Sovereigns	**8,226.2**	**–**	**–**	**–**	**–**	**–**	**8,226.2**
Financial Institutions	**322.0**	**516.9**	**13.6**	**–**	**–**	**–**	**852.5**
Structured	**–**	**–**	**3.8**	**–**	**–**	**–**	**3.8**
Other	**119.2**	**–**	**–**	**–**	**–**	**3.4**	**122.6**
Total	**8,667.4**	**516.9**	**17.4**	**–**	**–**	**3.4**	**9,205.1**

2016	Aaa-Aa3 £m	A1-A3 £m	Baa1-Baa3 £m	Ba1-B3 £m	Caa1-C3 £m	Unrated £m	Total £m
Central Bank and Sovereigns	5,706.2	–	–	–	–	–	5,706.2
Financial Institutions	333.6	445.5	19.8	–	–	–	798.9
Structured	–	–	7.6	–	36.5	–	44.1
Other	–	–	–	–	–	3.6	3.6
Total	6,039.8	445.5	27.4	–	36.5	3.6	6,552.8

[1] Exposures are measured and reported equivalent to those under CRR 575/2013: Part Four.

[2] The composite rating is derived from an average external rating.

Notes to the Accounts continued...

38. Wholesale credit risk continued...

The Group's low risk appetite outside the UK is reflected in the country exposures[1] by type shown in the tables below.

2017	**Central Banks and Sovereigns £m**	**Financial Institutions £m**	**Multilateral & Government Development Banks £m**	**Structured £m**	**Other £m**	**Total £m**
United Kingdom	**8,226.2**	**595.0**	**–**	**–**	**3.4**	**8,824.6**
France	**–**	**124.0**	**–**	**–**	**–**	**124.0**
United States	**–**	**107.6**	**–**	**–**	**–**	**107.6**
Germany	**–**	**0.2**	**80.3**	**–**	**–**	**80.5**
International	**–**	**–**	**38.9**	**–**	**–**	**38.9**
Switzerland	**–**	**10.2**	**–**	**–**	**–**	**10.2**
Canada	**–**	**7.6**	**–**	**–**	**–**	**7.6**
Australia	**–**	**6.5**	**–**	**–**	**–**	**6.5**
Netherlands	**–**	**–**	**–**	**3.8**	**–**	**3.8**
Denmark	**–**	**1.0**	**–**	**–**	**–**	**1.0**
Spain	**–**	**0.2**	**–**	**–**	**–**	**0.2**
Belgium	**–**	**0.2**	**–**	**–**	**–**	**0.2**
Total	**8,226.2**	**852.5**	**119.2**	**3.8**	**3.4**	**9,205.1**

2016	Central Banks and Sovereigns £m	Financial Institutions £m	Multilateral & Government Development Banks £m	Structured £m	Other £m	Total £m
United Kingdom	5,706.2	566.5	–	–	3.6	6,276.3
United States	–	118.9	–	–	–	118.9
Netherlands	–	93.2	–	–	–	93.2
Switzerland	–	–	–	24.3	–	24.3
Ireland	–	18.3	–	–	–	18.3
Cayman Islands	–	–	–	12.2	–	12.2
France	–	–	–	7.6	–	7.6
Canada	–	0.6	–	–	–	0.6
Denmark	–	0.6	–	–	–	0.6
Australia	–	0.4	–	–	–	0.4
Germany	–	0.3	–	–	–	0.3
Belgium	–	0.1	–	–	–	0.1
Spain	–	–	–	–	–	–
Total	5,706.2	798.9	–	44.1	3.6	6,552.8

[1] Country risk exposures for structured and RMBS are based on the country of origination for the asset.

38. Wholesale credit risk continued...

The Group's main Sovereign exposure is to the UK which had an average external rating of 'AA'. At the year end, UK Sovereign exposure was £7,502.0m (2016: £5,145.7m) to the Bank of England and £724.2m (2016: £560.5m) in UK government bonds.

The largest exposure to a single institution (other than the UK government) was £307m (2016: £319m) in both instances to a UK clearing bank.

None of the wholesale exposures is either past due or impaired and there are no assets that would otherwise be past due or impaired whose terms have been renegotiated.

The key trigger events used to evaluate impairments are set out in Note 1 on page 103.

In addition to the above direct exposures the Group regularly monitors indirect exposures (the primary exposures of our counterparties) to establish whether any second order concentration risks exist. This is performed on a best efforts basis given the inconsistency and timings of information that exists in the public domain with regards to this information.

Wholesale credit risk is recorded in the following Statement of Financial Position captions:

	2017 £m	2016 £m
Cash in hand and balances with the Bank of England	**4,893.9**	3,525.0
Loans and advances to credit institutions	**351.0**	542.8
Debt securities	**850.8**	608.1
Derivative financial instruments	**591.8**	540.5
Investments[1]	**6.3**	10.3
Total wholesale credit risk	**6,693.8**	5,226.7
Debt securities, which are shown after fair value and impairment adjustments, can be further analysed as:		
UK government securities	**724.2**	560.5
Medium-term notes issued by financial institutions	**3.6**	3.5
Fixed Rate Eurobonds	**119.2**	–
Combination note[2]	**3.8**	7.6
Synthetic collateralised debt obligations[3]	**–**	36.5
	850.8	608.1

[1] Principally an equity investment in VocaLink Holdings Limited, which is associated with the Group's operation of cash machines, and Preference shares in Visa Inc, in part consideration for a previous shareholding in Visa Europe following their acquisition by Visa Inc. in June 2016.

[2] The combination note continues to pay contractual coupons with no evidence of impairment. Changes in fair value are taken directly to the Income Statement.

[3] These relate to two holdings in synthetic credit investments. These contain embedded derivatives that have been separated with changes in fair value being taken directly to the Income Statement.

Notes to the Accounts continued...

39. Credit risk on loans and advances to customers

Credit risk management

The Group articulates its tolerance for credit risk through a series of risk appetite statements. These statements are supported by a number of qualitative and quantitative measures that are monitored closely by the Group Risk function and reported monthly to the Group's credit risk committees. Further challenge and oversight is provided by the Group Risk Committee which reviews credit risk reporting as part of their quarterly meetings.

The Group's exposure to credit risk on loans and advances to customers can be broken down as follows:

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Retail mortgages	**34,171.0**	33,134.0	**15,467.1**	16,629.8
Commercial lending	**1,053.4**	1,057.6	**1,050.9**	1,054.9
Unsecured lending	**2.0**	3.0	**2.0**	3.0
Total gross exposure (contractual amounts)	**35,226.4**	34,194.6	**16,520.0**	17,687.7
Impairment, fair value, EIR and hedging adjustments	**(165.2)**	(91.3)	**(182.7)**	(83.6)
Total net exposure	**35,061.2**	34,103.3	**16,337.3**	17,604.1

Lending by type

	2017 %	2016 %
Residential Prime	**84.5**	84.8
Residential Sub-Prime/Self-Cert	**1.8**	2.2
Buy-To-Let (Retail)	**10.7**	10.0
Closed Book Commercial	**–**	–
YBS/N&P Social Housing	**0.7**	1.0
N&P Commercial (exc. Social Housing)	**2.3**	2.0
	100.0	100.0

39. Credit risk on loans and advances to customers continued...

Retail mortgages

The Group's exposure to mortgage related credit risk is monitored closely by the Credit Risk area. Reporting on risk exposures is provided monthly to the Customer and Commercial Risk Committee. Reports include analysis of the movement of loans into arrears and between arrears bands by differing loan portfolios, as well as monitoring of the overall characteristics of the loan portfolios (e.g. geographic location, indexed LTV concentrations and affordability metrics). In addition, the Group undertakes a number of stress tests periodically that subject the mortgage portfolios to different levels of default, house price deflation and other factors to identify the potential loan losses under the different economic conditions represented by those stress tests.

At an operational level, adherence to the Group's retail credit risk appetite is supported through the use of a suite of tools used in activities such as credit decisioning, portfolio management and arrears management.

Geographic distribution of retail mortgage balances

	2017 %	2016 %
Scotland	**6.6**	6.5
North East	**3.7**	3.6
Yorkshire & Humberside	**9.1**	9.1
North West	**9.3**	9.1
Midlands	**11.3**	10.7
East Anglia	**4.4**	4.4
South West	**7.0**	7.0
Greater London	**20.0**	20.8
South East	**24.6**	24.9
Wales & Northern Ireland	**3.9**	3.8
Non-UK	**0.1**	0.1
	100.0	100.0

Notes to the Accounts continued...

39. Credit risk on loans and advances to customers continued...

Substantially all retail mortgage balances are secured on property. As part of the portfolio monitoring process, these properties are subject to regular updates in respect of their LTV by way of an indexation process. This is applied to provide some measure of relative house price movements across the UK and their impact on the relative property values. Although the indexation approach is very broad, typically at the regional level, it is an industry standard for providing senior management with a view as to the value and risk of the properties on which retail mortgages are secured.

Loan-to-value distribution of retail mortgage balances

	Book		New Lending	
	2017 %	2016 %	**2017 %**	2016 %
Greater than 100%	**0.2**	0.3	**–**	–
95 to 100%	**0.3**	0.3	**–**	–
90% to 95%	**1.4**	1.2	**5.4**	4.3
85% to 90%	**3.9**	3.1	**15.9**	13.6
80% to 85%	**6.6**	4.6	**17.8**	13.9
75% to 80%	**6.8**	5.7	**13.0**	11.8
70% to 75%	**7.9**	7.8	**13.6**	17.4
60% to 70%	**18.7**	20.8	**16.3**	19.2
Less than 60%	**54.2**	56.2	**18.0**	19.8
	100.0	100.0	**100.0**	100.0

The average indexed LTV, based on a simple average of each loan's indexed LTV, is 48.2% (2016: 47.7%).

Loan-to-value distribution of retail mortgage balances

	2017		2016	
	Not individually impaired %	**Individually impaired %**	Not individually impaired %	Individually impaired %
Greater than 100%	**0.2**	**–**	0.3	0.1
95 to 100%	**0.2**	**–**	0.3	–
90% to 95%	**1.4**	**–**	1.2	–
85% to 90%	**3.9**	**–**	3.0	–
80% to 85%	**6.5**	**–**	4.5	0.1
75% to 80%	**6.8**	**0.1**	5.6	0.1
70% to 75%	**7.9**	**0.1**	7.8	0.1
60% to 70%	**18.6**	**0.1**	20.6	0.1
Less than 60%	**54.0**	**0.2**	56.0	0.2
	99.5	**0.5**	99.3	0.7

39. Credit risk on loans and advances to customers continued...

Retail mortgage customer type

	Book		New Lending	
	2017 %	2016 %	**2017 %**	2016 %
First time buyer	**18.9**	19.2	**19.2**	19.5
Other buyers e.g. movers	**38.7**	40.1	**40.0**	33.9
Remortgage	**31.3**	30.4	**30.4**	34.6
Buy-to-let	**11.0**	10.3	**10.3**	12.0
Other	**0.1**	–	**0.1**	–
	100.0	100.0	**100.0**	100.0

Retail mortgage arrears

	Group		Society	
	2017 %	2016 %	**2017 %**	2016 %
Arrears outstanding as a percentage of debt				
No arrears	**97.4**	96.9	**97.1**	96.8
Less than three months	**2.1**	2.4	**2.4**	2.5
Equal to or more than three months, less than six months	**0.3**	0.4	**0.3**	0.4
Equal to or more than six months, less than 12 months	**0.1**	0.2	**0.1**	0.2
12 months or more	**0.1**	0.1	**0.1**	0.1
Property in possession	**–**	–	**–**	–
	100.0	100.0	**100.0**	100.0
Number of properties in possession at the year end	**73**	92	**45**	53

The percentage of retail mortgages with arrears of three months or more (as a % of outstanding balances, including possessions) has fallen during 2017 from 0.68% to 0.46%. The UK Finance industry average ratio for mortgage arrears is measured as the number of accounts more than three months in arrears (including possessions). At 0.56% (2016: 0.76%) our performance remains below the comparable UK Finance ratio 0.88% (2016: 0.95%). Arrears on more recent lending are minimal, reflecting the Group's credit risk appetite.

Notes to the Accounts continued...

39. Credit risk on loans and advances to customers continued...

Commercial lending

Commercial lending credit risk exposures are monitored by Group Risk and reported to the Customer and Commercial Risk Committee. Reporting includes analysis of book growth, sector distribution of book, geographic distribution, LTV analysis and the movement of loans into arrears and between arrears bands. Loans against specialist properties are strictly limited and we do not lend against land only. The Group assesses whether current valuations are appropriate by re-valuing properties periodically using third party valuation data which takes into account the property type and geographical location. Third party valuation data is also used to assess the risk of loss on individual loans and to monitor whether LTV covenants are met. Where borrowers are more than two months in arrears, consideration is given to obtaining a professional valuation of the property.

At 31 December 2017 the Group had a commercial lending book (including lending to housing associations on residential properties) of £1,053m. The Group originates commercial lending via its N&P brand, providing loans to commercial owner occupiers, commercial and residential property landlords (where the borrower is a corporate entity) and a small number of housing associations. The N&P commercial loan portfolio, which comprises 60.5% (2016: 67.2%) of the total commercial lending book, is managed by a specialist team using a combination of lending policy rules, underwriting and close relationship management to assess new applicants and manage existing loans. The majority of loans are advanced against commercial properties using a vacant possession valuation to mitigate against future losses.

This proactive approach to account management has resulted in only 0.26% of N&P commercial accounts being more than three months in arrears (as a % of outstanding balances, including repossessions) as at the year end (2016: 0.29%). While arrears and losses to date have been low, as part of the merger all acquired N&P commercial loans were subject to a fair value adjustment to reflect likely future losses on the portfolio.

We have a small closed commercial loan book which arose from the merger with Chelsea Building Society. The book is in run off and we do not write any new commercial business under the Chelsea brand. At 31 December 2017 there were two loans remaining with outstanding balances totalling £1.8m (2016: £18.7m). All loans are performing and are covenant compliant.

In addition to the N&P commercial lending book, we have an active business lending to housing associations, in England and Wales, via the Yorkshire Building Society brand, properly known as 'Registered Providers'. This sector has particularly robust credit characteristics and the lending is low risk albeit at low margins. We have an opportunistic approach to attracting new business, within the constraints of a Board approved risk appetite, and do so when returns and capital efficiency contribute to financial sustainability. At 31 December 2017 the loan book was £328.4m (2016: £327.9m). We have written further term loan facilities in the region of £55.0m (2016: £120.0m) and these will draw down over the next two to three years.

The Group commercial loan portfolio (including lending to housing associations) is spread throughout the UK as follows:

Geographic distribution of commercial mortgage balances

	2017 %	2016 %
Scotland	**–**	–
North East	**0.9**	1.4
Yorkshire & Humberside	**3.9**	2.7
North West	**5.4**	11.0
Midlands	**7.5**	6.5
East Anglia	**4.9**	3.3
South West	**5.8**	4.0
Greater London	**41.8**	28.1
South East	**28.4**	34.8
Wales	**1.4**	8.2
	100.0	100.0

39. Credit risk on loans and advances to customers continued...

N&P commercial mortgages by lending type

	2017 %	2016 %
Commercial owner occupied	**20.1**	25.3
Commercial investment property	**40.4**	39.1
Buy-to-let	**37.5**	33.6
Social housing	**2.0**	2.0
	100.0	100.0

The average LTV of the N&P commercial loan portfolio is 52.4% (2016: 54.3%). The LTV calculation has been undertaken using a combination of external professional valuations and indexation of the original valuation using data from the Investment Property Databank (IPD). IPD provides performance measurement services in the UK and Ireland on over 360 investment portfolios. Residential valuations are indexed using the ONS house price indices.

The total value of the security held against N&P commercial loans is estimated to be £1,721m (2016: £1,467m). £8.0m of the N&P exposures have an estimated LTV of greater than 100% (2016: £14.6m). Of these, loans totalling £0.8m are in arrears. The largest N&P exposure to a single counterparty at 31 December 2017 is £12.1m.

Loans monitored on the "watch list" include those where there are circumstances which could impact on the quality and safety of the loan. Examples include borrowers requesting forbearance (such as changing loan repayments to interest only for a period), or reporting trading losses. Loans on the watch list total £5.1m (2016: £9.3m). Our appetite and approach to the provision of commercial lending is to provide amortising term loans, typically over 10 – 25 years. We do not provide short-term, interest only facilities which require repayment on expiry through refinance. Where a period of interest only is agreed, it will be for a short period following which the loan will be structured to amortise over the remaining term. Buy-to-let loans are mainly interest only £312m (2016: £238m). These loans are continuously monitored to ensure that full repayment is made on the expiry of the loan term.

N&P commercial mortgage arrears

	2017 %	2016 %
Arrears outstanding as a percentage of debt		
No arrears	**99.2**	99.3
Less than three months	**0.5**	0.4
Three months or more	**0.2**	0.2
Property in possession	**0.1**	0.1
	100.0	100.0

Notes to the Accounts continued...

39. Credit risk on loans and advances to customers continued...

Unsecured lending

The Group has unsecured lending portfolios consisting of current accounts and personal loan portfolio, via its N&P brand. The Group has recently announced its intention to close its N&P current accounts to existing customers, and withdraw the N&P brand from the high street over the next year. As at 31 December 2017 unsecured lending balances stood at £2.0m (current account overdrafts of £1.0m, personal loans of £1.0m). Within the Group, unsecured lending is managed by the Credit Risk area within Group Risk, with monthly reporting provided to the Customer and Commercial Risk Committee. Reporting includes analysis of accounts in arrears and overdraft limits.

Current account overdrafts are assessed and managed using a combination of statistical credit models, lending policy rules and underwriting, with all overdraft limits reviewed on at least a monthly basis. Accounts are monitored closely for early signs of distress and advice offered to customers were deemed appropriate. Customers who are unable to repay overdrafts when due are passed to the Collections department who review individual customer circumstances before deciding what appropriate action to take. As at 31 December 2017, accounts that have been in excess of their agreed overdraft for three or more consecutive months stood at 8.0% of the portfolio by volume (2016: 0.8%).

The personal loan portfolio is currently in run-off. Customers who are unable to repay personal loans are passed to the Collections department who review individual customer circumstances before deciding what appropriate action to take. As at 31 December 2017, accounts which were within term and three or more months in arrears stood at 100.0% of the portfolio by volume (2016: 81.0%).

At the point of merger, as with all N&P loan books, a fair value adjustment was applied against all unsecured lending.

Impairment

All loans (retail mortgage, commercial and unsecured) are reviewed at each reporting date for indications of impairment.

The following table shows as at the year end, impairment on the overall loan balances as well as a prudent assessment of collateral held against total loans and advances. The collateral is calculated as the lower of the value of the property and the outstanding loan amount. It is not the overall value of properties secured against the loans.

39. Credit risk on loans and advances to customers continued...

	Loans and advances 2017 £m	2016 £m	Collateral 2017 £m	2016 £m
Group				
Not individually impaired:				
Neither past due nor individually impaired	**34,319.2**	33,140.1	**34,310.6**	33,127.0
Past due but not individually impaired	**742.3**	819.8	**742.2**	818.5
Individually impaired	**164.9**	234.7	**156.1**	220.9
Total loans and advances	**35,226.4**	34,194.6	**35,208.9**	34,166.4
Society				
Not individually impaired:				
Neither past due nor individually impaired	**16,063.3**	17,144.8	**16,060.8**	17,139.1
Past due but not individually impaired	**377.8**	430.2	**377.4**	430.0
Individually impaired	**78.9**	112.7	**72.2**	102.7
Total loans and advances	**16,520.0**	17,687.7	**16,510.4**	17,671.8

The loans and advances shown above exclude effective interest rate adjustments and credit loss fair values and therefore do not tie through directly to Note 16.

Impairment is assessed based on the arrears of each loan. Where retail or commercial mortgages are in arrears by three months or more, they are individually assessed for impairment.

Commercial loans less than three months in arrears are also individually impaired where other qualitative factors suggest a measureable decrease in the present value of their future cash flows, i.e. where they are included on the watch list as noted previously. Where retail or commercial mortgages are less than three months in arrears they are assessed for collective impairment.

Loans acquired on the merger with Chelsea in 2010 and N&P in 2011 were measured at fair value on acquisition, which makes allowances for expected losses over the remaining life of the loans. Any further losses from the past due loans totalling £291.6m at 31 December 2017 (2016: £379.1m), are unlikely to be significant to the Group.

Note 1 on page 103 describes the Group's approach to impairment provisioning and the key factors used in the calculation. The key model assumptions underpinning the current mortgage impairment provisions (shown in Note 9) are forecast house price inflation/(deflation), probability of possession, emergence period, loss given possession and forced sale discount.

Personal loans are individually assessed for impairment where they are more than one month in arrears and assessed for collective impairment if they are one month or less in arrears. Current accounts with overdraft facilities are assessed for impairment on a collective basis and the estimation of future losses takes into account historic experience.

Notes to the Accounts continued...

39. Credit risk on loans and advances to customers continued...

Forbearance

The Group uses forbearance tools where they are deemed appropriate for an individual customer's circumstances, in line with industry guidance. Forbearance tools, which the Group may offer, include capitalisation, interest only concessions, arrears arrangements, Direct Debit suspension and term extensions. The use of account management tools are either fully recognised within provisioning or are low in materiality.

The analysis below sets out a total of £1,477.1m (2016: £1,558.3m) mortgage balances which have been subject to some form of forbearance during the past two years. Balances totalling £129.3m (2016: £181.2m) are more than three months in arrears and therefore fall within the Group's individual provision calculation. The remaining £1,347.8m (2016: £1,377.1m) are covered by the Group's collective provision through the assumptions surrounding the emergence period. There is nothing in the forbearance data to suggest that the impairment provisioning methodology or assumptions do not provide adequate cover in respect of lending which is subject to forbearance.

Forbearance is included in mortgage provisions in the same way as any other debt, with that which is more than three months in arrears being recorded as impaired, and that which is less than or equal to three months being collectively assessed. If it were all to be incorporated as impaired the increase to the mortgage provision of £32.5m would be less than £1.0m (2016: increase from £45.0m would be less than £1.0m).

As at 31 December 2017	Arrears arrangements £m	Other concessions £m	Term extension £m	Interest only £m	Capitalisation £m	Total £m
Gross carrying amount						
Neither past due nor individually impaired;	351.8	167.2	536.9	8.5	2.3	**1,066.7**
Past due but not individually impaired;						
Less than one month	94.7	2.5	3.9	–	0.4	**101.5**
One to three months	175.2	2.1	2.2	–	0.1	**179.6**
	621.7	**171.8**	**543.0**	**8.5**	**2.8**	**1,347.8**
Impaired;						
Three to six months	78.3	0.4	–	–	–	**78.7**
Six to 12 months	33.4	–	–	–	–	**33.4**
12 months or over	12.3	0.4	–	–	–	**12.7**
Property in possession	4.4	0.1	–	–	–	**4.5**
	128.4	**0.9**	**–**	**–**	**–**	**129.3**
	750.1	**172.7**	**543.0**	**8.5**	**2.8**	**1,477.1**

39. Credit risk on loans and advances to customers continued...

As at 31 December 2016	Arrears arrangements £m	Other concessions £m	Term extension £m	Interest only £m	Capitalisation £m	Total £m
Gross carrying amount						
Neither past due nor individually impaired;	359.7	180.5	493.9	9.5	2.6	1,046.2
Past due but not individually impaired;						
Less than one month	105.7	2.3	4.2	0.3	0.5	113.0
One to three months	212.0	3.4	2.4	0.1	–	217.9
	677.4	186.2	500.5	9.9	3.1	1,377.1
Impaired;						
Three to six months	106.8	0.7	0.2	–	–	107.7
Six to 12 months	51.1	0.4	0.3	0.1	–	51.9
12 months or over	15.3	–	–	–	–	15.3
Property in possession	6.2	0.1	–	–	–	6.3
	179.4	1.2	0.5	0.1	–	181.2
	856.8	187.4	501.0	10.0	3.1	1,558.3

Arrears arrangements include positive and negative arrears arrangements. A positive arrears arrangement is one where the customer's regular monthly repayment is in excess of their contractual repayment amount in order to reduce their arrears. A negative arrears arrangement is one where an agreement is in place, due to the borrower's circumstances, that allows the customer to repay less than their contractual repayment amount for a short period. In this circumstance interest will continue to accrue on the unpaid amounts. Other concessions include the suspension of direct debits.

All requests for forbearance on commercial loans are subject to full credit risk appraisal and are predominantly for a period of interest only which allows the borrower to improve income from trading or rent receipts, or pending the sale of the property. The appraisal process considers the likelihood of a loss being sustained from any borrower granted a concession and ensures that the concession is in the interests of both the borrower and the Group. In 2017 there are 15 accounts in the N&P commercial loans portfolio totalling £2.3m with an interest only concession (2016: 16 accounts totalling £2.5m).

Notes to the Accounts continued...

40. Fair values

Fair value is the price that would be received to sell an asset or the price paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Where external market prices are available they have been used to determine fair value. Otherwise, internal pricing models using external market data have been used. The Group measures fair value using the following fair value hierarchy:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The table below summarises the carrying value and fair value of financial assets and liabilities measured at amortised cost as at the Statement of Financial Position date.

	Carrying value £m	Level 1 £m	Fair values Level 2 £m	Level 3 £m	Total fair value £m
Group					
At 31 December 2017					
Assets					
Cash in hand and balances with the Bank of England	**4,893.9**	**–**	**4,893.9**	**–**	**4,893.9**
Loans and advances to credit institutions	**351.0**	**–**	**351.0**	**–**	**351.0**
Loans and advances to customers	**35,061.2**	**–**	**–**	**35,559.9**	**35,559.9**
Liabilities					
Shares	**28,938.0**	**–**	**28,944.7**	**–**	**28,944.7**
Amounts due to credit institutions	**4,451.6**	**–**	**4,451.6**	**–**	**4,451.6**
Other deposits	**420.2**	**–**	**420.2**	**–**	**420.2**
Debt securities in issue	**4,933.3**	**4,299.8**	**745.0**	**–**	**5,044.8**
Subordinated liabilities	**593.7**	**566.8**	**48.1**	**–**	**614.9**
Subscribed capital	**6.4**	**–**	**6.3**	**–**	**6.3**

40. Fair values continued...

	Carrying value £m	Level 1 £m	Fair values Level 2 £m	Level 3 £m	Total fair value £m
Society					
At 31 December 2017					
Assets					
Cash in hand and balances with the Bank of England	**4,893.9**	**–**	**4,893.9**	**–**	**4,893.9**
Loans and advances to credit institutions	**126.6**	**–**	**126.6**	**–**	**126.6**
Loans and advances to customers	**16,337.3**	**–**	**–**	**16,650.2**	**16,650.2**
Liabilities					
Shares	**28,938.0**	**–**	**28,944.7**	**–**	**28,944.7**
Amounts due to credit institutions	**4,442.9**	**–**	**4,442.9**	**–**	**4,442.9**
Other deposits	**8,468.2**	**–**	**8,468.2**	**–**	**8,468.2**
Debt securities in issue	**4,192.1**	**4.299.8**	**–**	**–**	**4,299.8**
Subordinated liabilities	**593.7**	**566.8**	**48.1**	**–**	**614.9**
Subscribed capital	**6.4**	**–**	**6.3**	**–**	**6.3**

Notes to the Accounts continued...

40. Fair values continued...

	Carrying value £m	Level 1 £m	Fair values Level 2 £m	Level 3 £m	Total fair value £m
Group At 31 December 2016					
Assets					
Cash in hand and balances with the Bank of England	3,525.0	–	3,525.0	–	3,525.0
Loans and advances to credit institutions	542.8	–	542.8	–	542.8
Loans and advances to customers	34,103.3	–	–	34,698.9*	34,698.9
Liabilities					
Shares	28,693.2	–	28,641.2	–	28,641.2
Amounts due to credit institutions	3,120.8	–	3,120.8	–	3,120.8
Other deposits	434.7	–	434.7	–	434.7
Debt securities in issue	4,361.4	–	4,421.8	–	4,421.8
Subordinated liabilities	297.0	–	305.1	–	305.1
Subscribed capital	6.7	–	6.0	–	6.0
Society At 31 December 2016					
Assets					
Cash in hand and balances with the Bank of England	3,525.0	–	3,525.0	–	3,525.0
Loans and advances to credit institutions	257.2	–	257.2	–	257.2
Loans and advances to customers	17,604.1	–	–	17,894.0*	17,894.0
Liabilities					
Shares	28,693.2	–	28,641.2	–	28,641.2
Amounts due to credit institutions	3,111.4	–	3,111.4	–	3,111.4
Other deposits	6,898.8	–	6,898.8	–	6,898.8
Debt securities in issue	3,706.8	–	3,764.1	–	3,764.1
Subordinated liabilities	297.0	–	305.1	–	305.1
Subscribed capital	6.7	–	6.0	–	6.0

* Loans and advances to customers have been moved in the 2016 table to Level 3 for comparability to 2017 table.

40. Fair values continued...

The fair values of all cash in hand, balances with the Bank of England and loans and advances to credit institutions have been recorded at par as they are all due in under one year and there is no impairment.

Market prices have been used to determine the fair value of listed debt securities in issue, hence these have been transferred from Level 2 to Level 1 in the year.

The fair value of loans and advances to customers uses a Level 3 method and is assessed as the value of the expected future cash flows. Future cash flows are projected using contractual interest payments, contractual repayments and the expected prepayment behaviour of borrowers. Prudent assumptions are applied regarding expected levels of customer prepayments and the risk of defaults. The resulting expected future cash flows are discounted at current market rates to determine fair value.

For SVR mortgage products, the interest rate on such products is equivalent to a current market product rate and as such the Group considers the fair value of these mortgages to be equal to their carrying value.

Fixed rate mortgages have been discounted using current market product rates. The difference between book value and fair value results from market rate volatility relative to the fixed rate at inception of the loan; in addition to assumptions applied in relation to redemption profiles, which are regularly reviewed and updated where necessary.

As these redemption profiles are not considered to be observable by the market, then the fair value of loans and advances to customers is considered to be derived by using Level 3 valuation techniques, and has been transferred from Level 2 to Level 3 in the year.

Overall the fair value is higher than the carrying value by £498.7m (2016: £595.6m), which arises primarily due to the product rates being above prevailing market rates.

All of the Group's financial liabilities are initially recorded at fair value less directly attributable costs and are subsequently measured at amortised cost, other than derivative financial instruments or where an adjustment is made to certain fixed rate shares balances that are in hedging relationships. The fair value of shares and deposits that are available on demand approximates to the carrying value. The fair value of fixed term shares and deposits is determined from the projected future cash flows from those deposits, discounted at the current market rates. In 2017, the estimated fair value of share balances, using a Level 2 method is now higher than the carrying value by £6.7m (2016: £52.0m lower).

The fair value of debt securities, subordinated liabilities and subscribed capital are calculated using a Level 2 method based on observable market prices. The fair value of subordinated liabilities is higher than carrying value by £21.2m (2016: £8.1m) which arises primarily due to the interest rates on the notes being significantly below prevailing market rates.

The table on page 170 classifies all financial instruments held at fair value on the face of the Group's Statement of Financial Position according to the method used to establish the fair value.

Notes to the Accounts continued...

40. Fair values continued...

	Level 1 £m	Fair values Level 2 £m	Level 3 £m	Total fair value £m
Group				
At 31 December 2017				
Assets				
Debt securities – fair value	**–**	**–**	**3.8**	**3.8**
Embedded derivatives	**–**	**–**	**–**	**–**
Debt securities – available for sale	**843.4**	**–**	**3.6**	**847.0**
Debt securities – held to maturity	**–**	**–**	**–**	**–**
Derivative financial instruments	**–**	**560.8**	**31.0**	**591.8**
Investments	**–**	**–**	**6.3**	**6.3**
Liabilities				
Derivative financial instruments	**–**	**152.7**	**4.2**	**156.9**
Group				
At 31 December 2016				
Assets				
Debt securities – fair value	–	–	7.6	7.6
Embedded derivatives	–	–	(8.9)	(8.9)
Debt securities – available for sale	560.5	3.5	45.4	609.4
Debt securities – held to maturity	–	–	–	–
Derivative financial instruments	–	486.6	53.9	540.5
Investments	–	–	10.3	10.3
Liabilities				
Derivative financial instruments	–	329.8	18.2	348.0

40. Fair values continued...

The Group's Level 1 portfolio of available for sale debt securities comprises liquid securities for which traded prices are readily available.

Derivative financial instruments are also included and derivative assets and liabilities within Level 2 are valued from discounted cash flow models using yield curves based on observable market data.

Level 3 instruments

Debt securities – fair value relates to an investment in a collateralised debt obligation. During 2017, there has been a £3.8m reduction in the carrying value of this investment as a result of partial repayments. The valuation is obtained from third party brokers in order to determine the fair value as there is no active market for this investment.

If the Group were to look to sell the investments, it is uncertain whether the proceeds received would be £3.8m. A 10% increase/(decrease) in the valuation would lead to a £0.4m gain/(loss) in the Income Statement.

Debt securities – available for sale represents a private investment where the fair value is calculated using internal assumptions on a future transaction taking place.

Derivative financial instruments within Level 3 are interest rate swaps and equity index swaps. These are valued using the same valuation technique as Level 2 derivatives, namely present value calculations using interest rate curves. The interest rate swaps are balance tracking and the swap notional is projected, and changes over time to match the balance of the underlying mortgage portfolio.

The equity index swaps are linked to the performance of specific stocks market indices and are valued using prices obtained from counterparties.

The changes in the fair value of these instruments from movements in Level 3 parameters related to prepayment risk will largely offset across the interest rate swaps and equity index swaps as the Group is hedged across these positions. Sensitivity analysis to the individual Level 3 parameters has not been disclosed on the basis that the Group does not have a significant exposure to these.

Fair values of derivative financial instruments are disaggregated further in Note 34.

Investments relate to equity shares in industry wide banking and credit card service operations. They are valued based on the discounted future cash flows of the deferred cash consideration the Group is due on sale of their shareholding and the underlying market value of the shares.

A discount is applied to the valuation to reflect the marketability of the shares. A change in this assumption of 10% would change the value of the investment by £0.9m.

Notes to the Accounts continued...

40. Fair values continued...

The following table analyses movements in Level 3 portfolio.

	As at 31 December 2016 £m	Items recognised in the income statement £m	Net repayments in the period £m	Gains and losses recognised in other comprehensive income £m	Transfers into/(out of) Level 3 portfolio £m	As at 31 December 2017 £m
Assets						
Debt securities – fair value	7.6	–	(3.8)	–	–	3.8
Embedded Derivatives	(8.9)	5.7	3.2	–	–	–
Debt securities – available for sale	45.4	–	(45.4)	–	3.6	3.6
Derivative financial instrument	53.9	(18.2)	(4.7)	–	–	31.0
Investments	10.3	–	(5.2)	1.2	–	6.3
Liabilities						
Derivative financial instrument	18.2	(8.7)	(5.3)	–	–	4.2

Transfers between fair value hierarchies

Transfers between hierarchies occur when due to an increase or decrease in market activity, or changes to the significance of unobservable inputs meaning it is no longer possible to value the financial instrument using the current method.

41. Related parties

Identity of related parties

The Group and Society have related party relationships with their subsidiaries, joint venture, the pension schemes and key management personnel. The Group considers its key management personnel to be its directors.

Contributions to the pension scheme

The Society paid contributions of £22.2m to the pension scheme (2016: £24.0m).

Key management compensation

The key management personnel compensations are as follows:

	No. of key management personnel	**2017 £000**	No. of key management personnel	2016 £000
Short-term employee benefits		**2,476**		2,738
Post-employment benefits		**205**		6
Total key management personnel compensation	**12**	**2,681**	12	2,744

Key management compensation in 2017 includes amounts paid to key management personnel who both retired and joined the Society during 2017. The number of key management personnel at 31 December 2017 totalled nine.

Transactions with key management personnel

Key management personnel and their close family members have undertaken the following transactions with the Society under normal business terms.

	No. of key management personnel 2017	**Amounts in respect of key management personnel and their close family members* 2017 £000**	No. of key management personnel 2016	Amounts in respect of key management personnel and their close family members* 2016 £000
Mortgage loans				
At 1 January		**678**		460
Net movements in the year		**(210)**		218
At 31 December	**2**	**468**	3	678
Deposit accounts and investments				
At 1 January		**748**		611
Net movements in the year		**(257)**		137
At 31 December	**9**	**491**	11	748

* Net movements in the year include amounts relating to directors who joined or left the Society during 2017

Mortgage loans made to key management personnel and their close family members were granted in the ordinary course of business and are subject to repayment under normal lending terms. The maximum outstanding balances during the year were £678,490 (2016: £716,310).

Notes to the Accounts continued...

41. Related parties continued...

Amounts deposited by key management personnel and their close family members earn interest at the same rates offered to the public.

Key management personnel and their close family members paid interest totalling £7,800 (2016: £2,935), received interest totalling £4,245 (2016: £3,562), and paid no fees and commissions during the year. Interest paid includes amounts relating to 'offset' mortgages where savings balances are used to reduce the interest bearing balance of mortgage loans.

Transactions with subsidiaries

The Society enters into a number of transactions with its subsidiaries in the normal course of business. These include loans and shares. The value of related party transactions, outstanding balances at the year end and related income and expense for the financial year are as follows:

	2017 £m	2016 £m
Shares in subsidiaries		
At 1 January	**105.0**	105.8
Net movements	**(0.1)**	(0.8)
At 31 December	**104.9**	105.0
Loans to subsidiaries		
At 1 January	**17,848.9**	16,655.0
Net movements	**3,145.0**	1,193.9
At 31 December	**20,993.9**	17,848.9
Deposits from subsidiaries		
At 1 January	**6,733.8**	6,187.5
Net movements	**1,598.6**	546.3
At 31 December	**8,332.4**	6,733.8
Interest receivable on loans	**374.5**	411.7
Interest payable on deposits	**(71.5)**	(69.3)
Fees and expenses receivable	**43.4**	44.2
Fees and expenses payable	**0.2**	–

41. Related parties continued...

Transactions with joint venture

The outstanding investment in MutualPlus Ltd at 31 December 2017 and 31 December 2016 was £0.3m. MutualPlus Ltd was placed into Members' Voluntary Liquidation on 15 December 2016.

Other

The Society has an investment in Arkose Funding Limited. In 2014, a loan of £4.0m to Arkose Funding Limited was fully impaired.

The Group has a related party relationship with Sesame Bankhall Group Limited (SBG) as Alison Hutchinson was a Non Executive Director of an indirect parent company of SBG, Aviva Life Holdings UK Limited until 31 October 2017. SBG is a lending partner of Accord Mortgages Limited, a subsidiary of the Society and a Lead Panel Valuer for the Group. In 2017 Accord Mortgages Limited paid commission of £4.4m to SBG, in relation to lending completed via their network of independent financial advisers. Transactions are made on an arm's length basis.

The Group also has a related party relationship with Aviva Insurance Limited, as Mark Pain, Vice Chairman, was a Non Executive Director of this company until 30 September 2017; Alison Hutchinson was also a Non Executive Director from July to October 2017. The Group historically sold insurance products provided by Aviva Insurance Limited, the income from these sales in 2017 was £0.4m.

42. Available for sale and hedging reserve

Amounts within the Available for sale reserve are transferred to the Income Statement upon the disposal of debt securities. During the year a gain of £8.0m (2016: £0.7m) was recognised in net realised gains.

The hedging reserve relates to fair value adjustments on derivative financial instruments designated as cash flow hedges. The Group applies cash flow hedge accounting to a portfolio of interest rate swaps which are economically hedging either floating rate assets, floating rate liabilities or highly probable forecast issuance of debt. Amounts within the cash flow hedging reserve are transferred to the Income Statement upon the de-designation of these hedge relationships. During the year a £3.8m loss (2016: £46.0m loss) was transferred to net gains/(losses) from fair value volatility on financial instruments in the Income Statement with respect to cash flow hedge accounting adjustments.

Notes to the Accounts continued...

43. Cash flows from other operating activities

	Group		Society	
	2017 £m	2016 £m	**2017 £m**	2016 £m
Working capital adjustments:				
Depreciation and amortisation	**31.4**	22.7	**31.4**	22.7
Profit on sale of assets	**(1.9)**	(11.8)	**(1.9)**	(11.8)
Interest on subordinated liabilities and subscribed capital	**19.1**	16.0	**19.1**	16.0
Provisions	**30.5**	17.1	**36.3**	15.9
Fair value of subordinated liabilities and subscribed capital	**1.4**	10.9	**1.4**	10.9
Loss on realisation of debt securities	**(6.1)**	(1.8)	**(6.1)**	(1.8)
Increase in other assets	**(6.7)**	(9.5)	**(5.1)**	(7.1)
Decrease in other liabilities	**(15.9)**	(36.6)	**(20.5)**	(38.0)
Working capital adjustments	**51.8**	7.0	**54.6**	6.8
(Increase)/decrease in operating assets:				
Loans and advances to customers	**(948.1)**	(781.7)	**1,270.7**	474.0
Investments	**4.0**	(8.9)	**(3,140.9)**	(1,202.3)
Derivative financial instruments	**(177.9)**	23.8	**(147.8)**	209.1
Net increase in operating assets	**(1,122.0)**	(766.8)	**(2,018.0)**	(519.2)
Increase/(decrease) in operating liabilities:				
Shares	**244.8**	1,296.8	**244.8**	1,296.8
Amounts owed to credit institutions	**1,330.8**	(181.6)	**1,331.5**	(181.6)
Other deposits	**(14.5)**	(109.6)	**1,569.4**	455.9
Net increase in operating liabilities	**1,561.1**	1,005.6	**3,145.7**	1,571.1

Annual Business Statement

1. Statutory percentages

	2017 %	Statutory Limit %
Lending limit	**3.4**	25.0
Funding limit	**25.3**	50.0

The above percentages have been calculated in accordance with the provisions of the Building Societies Act 1986.

The Lending limit measures the proportion of business assets not in the form of loans fully secured on residential property.

The Funding limit measures the proportion of shares and borrowings not in the form of shares.

The statutory limits are as laid down under the Building Societies Act 1986 and ensure that the principal purpose of a building society is that of making loans which are secured on residential property and are funded substantially by its members.

2. Other percentages

	2017 %	2016 %
As a percentage of shares and borrowings:		
Gross capital	**7.72**	6.90
Free capital	**7.37**	6.50
Liquid assets	**15.73**	12.77
Profit after taxation for the financial year as a percentage of mean total assets	**0.30**	0.29
Management expenses as a percentage of mean total assets	**0.83**	0.89

The above percentages have been prepared from the Group 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, hedging reserve, available for sale reserve, subordinated liabilities and subscribed capital.
- 'Free capital' represents the aggregate of gross capital and collective impairment provision less property, plant and equipment, intangible assets and investment properties.
- 'Liquid assets' represent the total of cash in hand and balances with the Bank of England, loans and advances to credit institutions, debt securities and other liquid assets.
- 'Mean total assets' represent the amount produced by halving the aggregate of total assets at the beginning and end of the financial year.
- 'Management expenses' represent the aggregate of administrative expenses, depreciation and amortisation.

Annual Business Statement continued...

3. Information Relating to the Directors at 31 December 2017

Director Name and Date of Birth	Business Occupation	Date of Appointment	Other Directorships
J. R. Heaps, LLB 8 July 1953	Chairman	20 November 2014	TheCityUK Limited The Garden Bridge Trust
N. A. K. Atkar, BSc 11 November 1965	Non Executive Director	25 April 2017	British Business Bank plc British Business Finance Ltd British Business Financial Services Ltd National Financial Services Skills Academy
A. E. Hutchinson, CBE, BSc 5 February 1967	Charity Chief Executive	4 February 2015	Your Penny Limited
G. R. Ireland, BSc, FCA 17 May 1953	Non Executive Director	1 September 2015	Aspen Insurance Holdings Ltd Aspen Insurance UK Ltd Iccaria Insurance ICC Ltd
A. B. Lenman, MA, ACMA 25 December 1969	Chief Finance Officer and Executive Director	4 December 2017	None
M. A. Pain, BSc, FCA 15 June 1961	Non Executive Director	1 August 2013	Ladbrokes Coral Group plc London Square Developments (Holdings) Ltd London Square Limited LSQ Management Ltd Somerset House Enterprises Ltd Somerset House Trust
G. P. C. Parsons, BA 31 July 1963	Company Director	1 May 2013	EasyHotel plc EasyHotel UK Ltd
M. C. Regnier, MEng, MBA 30 September 1971	Chief Executive Officer and Executive Director	3 June 2014	BCS Loans and Mortgages Ltd
S. C. White, BComm 4 April 1971	Chief Operating Officer and Executive Director	24 February 2016	Accord Mortgages Limited Yorkshire Key Services Limited Yorkshire Key Services (No2) Ltd YBS Properties Ltd YBS Properties (Edinburgh) Ltd YBS Properties (York) Ltd

The contractual notice period for Mr M C Regnier and Mr S C White is one year. Mr M. C. Regnier entered into a contract on 3 June 2014 and Mr S. C. White entered into a contract on 24 February 2016 on this basis. The contractual notice period for Mr A. B. Lenman is six months and he entered into a contract on 4 December 2017 on this basis.

Documents may be served on the above-named directors: Ref. 'Yorkshire Building Society' c/o Deloitte LLP at the following address: 1 City Square, Leeds LS1 2AL.

4. Registered Office

Yorkshire Building Society is a building society incorporated and domiciled in the United Kingdom. The address of the principal office is Yorkshire House, Yorkshire Drive, Bradford, BD5 8LJ.

Glossary

The following glossary defines terminology used within the Annual Report and Accounts:

Additional Tier 1 (AT1) capital	Any remaining eligible Permanent Interest Bearing shares.
Arrears	A customer is defined as in arrears when they fall behind in meeting their obligations to pay their mortgage and as a result there is an outstanding loan commitment that is overdue.
Basel	The Basel Committee on Banking Supervision's statement of best practice that defines the methods by which firms should calculate their regulatory capital requirements to retain enough capital to protect the financial system against unexpected losses. Enacted in the European Union via capital requirements directives.
Buy-to-let (BTL)	Lending on property that is to be let to individuals.
Capital Requirements Directive (CRD)	European legislation giving force to the Basel regulatory capital framework in the UK. The latest legislation – the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD) (together commonly referred to as CRD IV) came in to effect from 1 January 2014.
Collateralised debt obligations	Structured financial products issued by a third party which reference asset backed securities and/or certain other related assets purchased by the issuer.
Collateral (for loans and advances to customers)	Security (property) pledged for the repayment of a loan. Collateral is valued as the lower of the value of the property or the outstanding loan amount.
Commercial lending	Secured loans to a commercial borrower.
Common Equity Tier 1 (CET1) capital	The highest quality regulatory capital resources, comprising retained earnings less regulatory adjustments, as defined under CRD IV. Equivalent to Core Tier 1 defined under previous CRD legislation.
Common Equity Tier 1 capital ratio	The ratio of Common Equity Tier 1 Capital to Risk Weighted Assets.
Contractual maturity	The final payment date of a loan or financial instrument, at which all the outstanding loan and interest is repayable.
Cost:income ratio	A ratio that represents management expenses as a percentage of total income.
Council of Mortgage Lending (CML)	A not-for-profit organisation and trade association for the mortgage lending industry.
Covered bonds	A type of wholesale funding backed by cash flows from mortgages.
Credit risk	The risk of financial loss arising from a failure of a customer or counterparty to settle their financial and contractual obligations as they fall due.
Credit Valuation Adjustment (CVA)	These are adjustments applied to the fair values of derivatives to reflect the creditworthiness of the counterparty.
Currency risk	The exposure to risk from assets and liabilities denominated in currencies other than Sterling.
Debt securities In issue	Transferable certificates of indebtness including certificates of deposits, and fixed and floating rate notes.
Debit Valuation Adjustment (DVA)	These are adjustments applied to the fair values of derivatives to reflect the entity's own credit risk.

Glossary continued...

Derivative financial instruments	Contracts or agreements whose value is derived from one or more underlying prices, rates or indices inherent in the contract or agreement, such as interest rates, exchange rates or stock market indices. Examples of derivatives include interest rate swaps, forward rate agreements and futures.
Effective interest rate	The method used to calculate the amortised cost of financial instruments and to recognise interest receivable or payable over the relevant period. The effective interest rate is the rate that exactly discounts estimated cash flows (excluding credit losses) to zero, through the expected life of the instrument.
Expected loss	An estimate of the potential losses on current exposures due to potential defaults on a mid-cycle assumption.
Exposure	The maximum loss that a financial institution might suffer if a borrower or counterparty fails to meet its obligations to the Group.
Fair value	The value of the assets based on either the external market price or internal pricing models (using external data).
Financial Conduct Authority (FCA)	The UK conduct regulator which is responsible for regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. The FCA's objective is to protect consumers, promote competition and enhance market integrity.
Financial Ombudsman Service (FOS)	An independent service which provides a service for settling disputes between financial services providers and their customers.
Financial Services Compensation Scheme (FSCS)	A protection fund for depositors of failed institutions. This is funded by the financial services industry and each firm, including the Society, is obliged to pay an annual levy.
Forbearance	The Group grants concessions to assist borrowers who experience difficulties in meeting their obligations to pay their mortgage. Examples of forbearance tools are described in Note 39.
Funding for Lending Scheme (FLS)	A scheme launched by the Bank of England and HM Treasury designed to boost lending to households and businesses. Banks and building societies participating in the scheme can access funding at rates below the natural market rate.
Impaired loans	Loans which have been assessed and there is evidence to suggest a measurable decrease in the present value of cash flows expected from the loans that have occurred after initial recognition of the asset, but before the statement of financial position date.
Individual Liquidity Adequacy Assessment Process (ILAAP)	The Group's internal assessment of the levels of liquidity that need to be held by the Society to meet its regulatory liquidity requirements.
Individually impaired loans	Where retail or commercial mortgages are in arrears by three months or more, they are individually assessed for impairment. Commercial loans less than three months in arrears are also individually impaired where other factors suggest a measurable decrease in the present value of their future cash flows.
Internal Capital Adequacy Assessment Process (ICAAP)	The Group's internal assessment of the levels of capital that need to be held by the Society to meet its regulatory capital requirements.
International Financial Reporting Standards (IFRS)	International Financial Reporting Standards issued by the International Accounting Standards Board (IASB).

Liquidity Coverage Ratio (LCR)	A liquidity metric which aims to ensure that a firm maintains an adequate level of liquidity to meet its needs for a 30 calendar day time horizon under a severe stress scenario.
LIBOR (London Interbank Offered Rate)	A benchmark interest rate which banks can borrow funds from other banks in the London interbank market.
Liquidity risk	The risk that the Group does not hold sufficient liquidity, in terms of quantity and quality, to meet its liabilities as they fall due.
Loan loss provisions	A provision which is held against loans and advances to customers, representing management's best estimate of losses incurred in the loan portfolio at the reporting date.
Loan-to-value (LTV)	A ratio showing outstanding loan balance as a percentage of the value of the security.
Loss given possession	The loss that is expected to crystallise when a repossessed property is sold.
Medium-term notes (MTN)	Corporate notes continuously offered by a company to investors through a dealer. Investors can choose from differing maturities.
Member	A person who has a share account or a mortgage loan with the Society.
Minimum Requirement for Own Funds and Eligible Liabilities (MREL)	The minimum requirements a financial institution must hold to meet the loss absorption and recapitalisation components if an institution were to fail.
Net interest income	The difference between the interest received on assets and the interest paid on liabilities.
Net interest margin	This ratio calculates the net interest income as a percentage of mean total assets.
Operational risk	The risk of direct and indirect loss resulting from inadequate or failed internal processes, people and systems or from external events.
Other income	The income received from selling non-mortgage and savings products (e.g. home and contents insurance, investment products and other insurances).
Permanent Interest Bearing Shares (PIBS)	Unsecured, Sterling denominated Tier 1 capital instruments repayable at the option of the Society.
PRA Remuneration Code	Guidance provided by the PRA on directors' remuneration.
Probability of possession	The likelihood of an account moving into possession. This is used when calculating loan loss provisions.
Prudential Regulation Authority (PRA)	The UK prudential regulator, which is a part of the Bank of England and alongside the FCA has responsibility for the oversight of building societies, banks and insurers. The PRA's objective is to promote the safety and soundness of regulated firms.
Repossessions	Property taken into ownership by the Society as a result of the borrower's failure to make contractual loan repayments.
Residential Mortgage Backed Securities (RMBS)	An asset backed security that represents a claim on the cash flows from residential mortgage loans through a process known as securitisation.
Risk appetite	The level of risk that the Group is willing to take (or not take) in order to safeguard the interests of members whilst achieving business objectives.
Risk weighted assets	A regulatory measure that adjusts the value of assets to reflect their level of risk when calculating capital requirements.

Glossary continued...

Securitisation	A process by which a group of assets, usually loans, are aggregated into a pool which is used to back the issuance of debt securities in issue. A firm transfers these assets to a special purpose vehicle which then issues securities backed by the assets. The Group has established securitisation structures as part of its funding activities and uses residential mortgages as the asset pool.
Shares	Money deposited by members in a retail savings account with the Society and held as a liability in the Statement of Financial Position.
SONIA (Sterling Overnight Interbank Average)	An index that tracks actual market overnight funding rates calculated as a weighted average overnight deposit rate for each business day.
Subordinated liabilities	Tier 2 capital that is subordinated to the claims of all depositors, creditors and members holding shares in the Society (other than holders of PIBS).
Term Funding Scheme (TFS)	A scheme launched by the Bank of England designed to boost lending to households and businesses by providing term funding to banks and building societies participating in the scheme at rates close to Bank Rate.
Tier 1 (T1) capital	The sum total of Common Equity Tier 1 and Additional Tier 1 capital.
Tier 1 capital ratio	The ratio of Tier 1 capital to risk weighted assets.
Tier 2 (T2) capital	A measure of regulatory capital that includes subordinated liabilities and provisions for collective impairment, less regulatory adjustments.
Total capital	The total capital resources, including retained earnings, PIBS, provisions for collective impairment and subordinated liabilities, less regulatory adjustments.
Total capital ratio	The ratio of total capital to risk weighted assets.
UK Corporate Governance Code	The UK Corporate Governance Code, published by the Financial Reporting Council (updated in 2016), which sets out standards of good practice in relation to Board leadership and effectiveness, accountability and remuneration.
Value at Risk (VaR)	A risk management tool which evaluates the potential losses that may be incurred as a result of movements in market conditions over a specified holding period and to a given level of confidence.
Watch list	The watch list is used by the N&P commercial lending team to flag those loans where there are circumstances which could impact on the quality and safety of the loan.
Wholesale funding	The funding that is available between banks and other financial or commercial institutions. Examples of wholesale funding include covered bonds, deposits and government guarantees.

The following glossary defines Alternative Performance Measures (APM) used within the Annual Report and Accounts:

APM	Closest equivalent statutory measure/ Calculation of measure	Reconciling items to statutory measure	Definition and purpose
Income Statement measures			
Core operating Profit	Profit before tax.	A full reconciliation between profit before tax as shown in the Income Statement and core operating profit is shown in the Strategic Report on page 31.	Profit before tax excluding the impact of non-core items, both positive and negative, such as timing differences that reverse over time (e.g. fair value adjustments) or items of a one-off nature (e.g. asset sales). The Group considers this to be an important measure of underlying financial sustainability, and provides readers with helpful additional information on the underlying performance of the business across periods. It is consistent with how business performance is reported to and assessed by the Board.
Cost:income ratio	Management expenses (the aggregate of administrative expenses, depreciation and amortisation) as a percentage of total income.	Administrative expenses and depreciation and amortisation (management expenses) and total income are as shown in the Income Statements on page 94.	This is an industry-standard measure of the Group's costs in relation to its income. This is used by the Group to monitor and manage its overall cost position and understand how efficient the Group is at generating income.
Management expense ratio	Management expenses (the aggregate of administrative expenses, depreciation and amortisation) as a percentage of mean total assets.	Administrative expenses and depreciation and amortisation (management expenses) are as shown in the Income Statements on page 94. Mean total assets are calculated by taking the average of the value of the opening balance for the year and the value of the closing balance, as shown in the Statements of Financial Position on page 96.	This is an industry-standard ratio of the Group's costs as a proportion of its mean assets during the year, and is used to measure how efficient the Group is at maintaining its asset base.
Net interest margin	Net interest income as a percentage of mean total assets.	Net interest income is as shown in the Income Statements on page 94. Mean total assets are calculated by taking the average of the value of the opening balance for the year and the value of the closing balance, as shown in the Statements of Financial Position on page 96.	This is an industry-standard measure of the relationship between net interest income (the difference between the interest received on assets and the interest paid on liabilities) and assets. This is a key measure used by the Board to monitor how the Group manages income from its assets and interest paid on funding.

Glossary continued...

APM	Closest equivalent statutory measure/ Calculation of measure	Reconciling items to statutory measure	Definition and purpose
Statement of Financial Position items			
Average LTV on new lending	None	Not applicable	The simple average LTV of all the new mortgage accounts opened by the Group during the year. LTV is calculated at individual account level and represents the loan advanced as a percentage of the value of the property at the time of the loan. Average LTV is an important measure of the risk of the new lending advanced during the year. Higher LTV is associated with higher risk, as it represents greater exposure to falling house prices.
Gross lending	None	Not applicable	The total value of mortgage loans advanced by the Group in the period, including loans for house purchase, further advances, remortgages etc.
Lending to first time buyers	None	Not applicable	The total value of mortgage loans advanced by the Group in the period to first time home buyers. This measure displays how the Group is helping people overcome the challenge of buying their first property.
Liquidity ratio	Cash in hand and balances with the Bank of England, loans and advances to credit institutions and debt securities as a percentage of shares and borrowings.	Cash in hand, balances with the Bank of England, loans and advances to credit institutions, debt securities, and shares are as shown in the Statements of Financial Position on page 96. Borrowings comprise amounts owed to credit institutions, other deposits and debt securities in issue, also as shown in the Statements of Financial Position on page 96.	The liquidity ratio measures those assets available to meet requests by savers to withdraw their money, to fund mortgage advances and to fund general business activities. It expresses cash and assets easily converted into cash as a percentage of the Group's liabilities to investors.
Mortgages funded by retail savings and retained profits	Shares and total reserves as a percentage of loans and advances to customers.	Shares, total reserves and loans and advances to customers are as shown in the Statements of Financial Position on page 96.	The retail savings and reserves to mortgages ratio shows the extent to which the Group is dependent on financing from the wholesale markets.
Mortgage growth	Loans and advances to customers at the end of the year less loans and advances to customers at the start of the year.	Loans and advances to customers are as shown in the Statements of Financial Position on page 96.	Movement in mortgage balances including impairment provisions and fair value accounting adjustments over the period.
Net lending	Loans and advances to customers at the end of the year less loans and advances to customers at the start of the year, excluding movements in provisions and accounting adjustments detailed in Note 16.	Mortgage growth less movements in provisions and accounting adjustments detailed in Note 16.	Net lending represents gross lending less repayment of principal and redemptions, and is a key measure to monitor the Group's overall lending performance. This measures our effectiveness in both new mortgage lending and in retaining borrowers.

APM	Closest equivalent statutory measure/ Calculation of measure	Reconciling items to statutory measure	Definition and purpose
Number of accounts more than three months in arrears	None	Not applicable	The number of mortgage accounts where the amount of arrears is greater than three monthly payments, or the account is in possession, as a proportion of the total number of mortgage accounts. The industry average for mortgage arrears is measured as the number of accounts more than three months in arrears (including possessions). We produce this KPI to assess how our level of mortgage arrears compares to the market.
Overall indexed LTV of the Group mortgage book	None	Not applicable	The simple average indexed LTV of all the mortgage accounts open at the end of the year. Indexed LTV is calculated at individual account level and represents the outstanding loan balance as a percentage of the market value of the property at that point. Market values are obtained from an external system used for such purposes within the UK. Indexed LTV measures the exposure of the entire mortgage book to falling house prices at any point in time, and hence is an important measure of the risk in the portfolio.
Percentage of outstanding retail mortgage balances in arrears by three months or more	None	Not applicable	The percentage of mortgage account balances where the amount of arrears is equal to or greater than three monthly payments, or the account is in possession, as a proportion of the entire mortgage book. This measures the overall quality of our mortgage book.
Savings balance growth	Shares at the end of the year less shares at the start of the year.	Shares are as shown in the Statements of Financial Position on page 96.	Movement in overall savings balances over the period, including capitalised interest and accounting adjustments.
Savings inflow/ outflow	None	Not applicable	Displays the cash in/out of savings accounts held, excluding capitalised interest. The Group uses this to monitor its main funding source throughout the year.
Savings rate differential	None	Not applicable	Calculates the average savings rate applied to the Group's savings accounts during the period versus the average UK savings interest rates for the rest of the market, based on savings stock from CACI's Current Account and Savings Database (CSDB), covering 86% of retail savings market (based on stock value). This is used to assess how much the Group is paying out in interest in comparison to peers.
Share of the gross mortgage market	None	Not applicable	Displays the Group's total gross lending as a percentage of the gross lending in the UK housing market by banks, building societies and other lenders as measured by the Council of Mortgage Lenders (CML), which represents 97% of the UK mortgage market. From 1 July 2017 the Council of Mortgage Lenders integrated into a new trade association, UK Finance.

Glossary continued...

APM	Closest equivalent statutory measure/ Calculation of measure	Reconciling items to statutory measure	Definition and purpose
Regulatory Measures			
Common Equity Tier 1 (CET1) capital ratio	None	Common equity tier 1 capital as defined in Note 31 as a percentage of risk weighted assets. The full calculation of CET1 ratio is shown in Note 31.	This ratio represents the relationship between the strongest form of capital (primarily accumulated profits that have built up over time) and assets, weighted by the level of risk they carry. It is a regulatory-defined ratio whose purpose is to ensure that institutions are able to absorb unexpected losses. It is a key measure of financial sustainability.
Leverage ratio	Reserves as a percentage of total assets.	Tier 1 capital as defined in Note 31 as a percentage of total assets adjusted for certain off-balance sheet exposures.	The leverage ratio is also a regulatory-defined ratio used to assess capital adequacy, but removes the risk-weighting element of assets. It is therefore a more simplified measure of financial sustainability.
Total capital ratio	None	Total capital as defined in Note 31 as a percentage of risk weighted assets. The full calculation of total capital ratio is shown in Note 31.	This measure is used to assess the total amount of capital the Group retains compared to its risk weighted assets, hence it includes externally issued capital. It is also defined by the regulatory authorities.
Non-financial measures			
Absenteeism	None	Not applicable	This indicator is for measuring the average absenteeism rate, as a % of the total working days. This KPI can be an indicator of colleague motivation as a high absence rate may indicate poor motivation and engagement.
Best Workplaces survey result	None	Not applicable	This is an external benchmarking exercise conducted by Great Places to Work®, involving an employee survey and a culture audit. The Group uses this measure to understand how successful we are at delivering our vision as a workplace where our people can give their best and thrive. This monitored annually and reported to the Board as a colleague engagement measure.
Existing customer trust score and rank	None	Not applicable	We measure progress against our vision 'to be the most trusted provider of financial services in the UK' through a survey conducted by YouGov which asks YBS Group customers whether 'YBS is an organisation you can trust', capturing the percentage who agree with the statement.

APM	Closest equivalent statutory measure/ Calculation of measure	Reconciling items to statutory measure	Definition and purpose
Net Promoter Score (NPS)	None	Not applicable	NPS is a measure of how willing customers are to recommend the Group to others. It measures the difference between the percentage of 'promoters' (those willing to recommend the Group to others) and 'detractors' (those unwilling to recommend the Group). The score can range from -100 if all customers are 'detractors' to +100 if all customers are 'promoters'. The Group uses this as a key measure of customer satisfaction with our products and service.
Resignation rate	None	Not applicable	This measures the number of colleagues who resign from the Group as a proportion of the total number of colleagues. This measure is used to assess whether colleagues feel satisfied working at YBS Group.
KPMG Nunwood customer experience survey result	None	Not applicable	The KPMG Nunwood survey ranks UK brands based on their customer experience, and is used by the Group to assess the experience we deliver our customers in relation to other UK organisations in various industries.
Simplicity pillar score	None	Not applicable	A core strategic priority is to make things easier and simpler both for our customers and our people. Our primary measure of ease of interaction with the Group is the simplicity score, which captures the proportion of positive responses to the survey question "YBS Group is simple to do business with" across all core areas of the Group, capturing both broker and customer feedback.
Colleague engagement score	None	Not applicable	Our annual colleague engagement survey is used to calculate an engagement score which helps to understand our people's needs and what will lead to their enjoyment and commitment in work.
End Youth Homelessness fundraising	None	Not applicable	Creating a partnership with organisations that have the same purpose, values and ethics as us is a key part of our Society Matters strategy. As a building society one of our core purposes is to help people into a home at every stage in their life, and this is reflected through our partnership with End Youth Homelessness.
Colleagues participating in volunteering	None	Not applicable	We aim to be an active member of the communities we serve. We measure our impact in the community by assessing the proportion of our colleagues who made use of their volunteering allowance to share their skills and make a difference to charities and other good causes.

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