YBS GROUP

Interim Management Report
for the six months ended 30 June 2018

Our purpose of providing real help for real life for our customers is at the heart of everything we do.

Chief Executive's summary

A good start to the year...

I am pleased to report on a good start to 2018 for Yorkshire Building Society. Above all we are focused on our ability to deliver high levels of service to our customers and our customer experience measure has remained significantly ahead of industry averages. We also saw growth in core profits and total mortgage balances and achieved a number of key milestones in our change plans.

SAVINGS

RETAIL SAVINGS BALANCES
£28.8bn
(31 December 2017: £28.9bn)

Deposit balances have been managed to ensure strong liquidity and to support lending growth.

MORTGAGES

OVERALL MORTGAGE BALANCES
£35.4bn
(31 December 2017: £35.1bn)

GROSS LENDING*
£4.0bn
(30 June 2017: £3.4bn)

NET LENDING*
£365m
(30 June 2017: -£2.0m)

Our lending performance remains in line with plans.

ASSET QUALITY*
0.41%
(31 December 2017: 0.46%)

The value of retail mortgages three months or more in arrears (including possessions) continues to reduce.

FINANCIAL

STATUTORY PROFIT BEFORE TAX
£88.6m
(30 June 2017: £92.3m)

CORE OPERATING PROFIT*
£86.3m
(30 June 2017: £84.2m)

Growth in underlying core profitability as a result of cost reductions more than offsetting reduced interest income as competitive pressure on margins continues.

LIQUIDITY
£6.0bn
(31 December 2017: £6.1bn)

LIQUIDITY RATIO*
15.4%
(31 December 2017: 15.7%)

LIQUIDITY COVERAGE RATIO*
150%
(31 December 2017: 165%)

Levels remain significantly above regulatory requirements.

COMMON EQUITY TIER 1 CAPITAL*
16.1%
(31 December 2017: 15.8%)

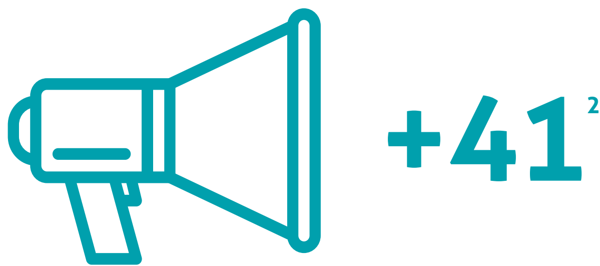
TOTAL CAPITAL RATIO*
20.2%
(31 December 2017: 20.1%)

LEVERAGE RATIO*
5.7%[1]
(31 December 2017: 5.6%)

MREL LEVERAGE RATIO*
7.2%
(31 December 2017: 7.2%)

The above results support our aim to make a level of profit to allow our business to grow at a sensible and healthy rate. We have achieved this goal whilst continuing to offer excellent value products and great customer service to our customers. This aligns to our vision "to be the most trusted provider of financial services in the UK".

1 Leverage ratio modified under the UK regulatory regime by excluding central bank reserves from the calculation of leverage exposures.
* These performance measures are defined in the glossary on pages 179 to 187 of the 2017 Annual Report and Accounts



+41[2]

Our Net Promoter Score® for the first six months

Our customer experience measure continues to be significantly higher than the industry average. This is measured through Net Promoter Score[3], which is a universally recognised metric that allows us to measure customer advocacy and loyalty. Our performance for the first six months of this year is +41 which is in line with where we ended last year, and ahead of the industry average[4] of +3.

2. KPMG Nunwood Customer Voice Programme, January – May 2018. Based on 7,601 completed interviews with customers. Net Promoter, Net Promoter Score and NPS are trademarks of Satmetrix Systems, Inc., Bain & Company, Inc., and Fred Reichheld.
3. Net promoter score is defined on page 187 of the 2017 Annual Report and Accounts.
4. Nunwood Customer Experience Excellence Annual Study average Net Promoter Score of +3 for the UK financial services sector, correct as at September 2017.

Chief Executive's summary continued...

Strategic update:

- Continuing to deliver the brand, product and distribution changes announced last year. In particular we have now closed the current account and over the weekend of 7/8 July we successfully rebranded the remaining N&P branches to YBS and migrated over 280,000 N&P savings customers to YBS accounts, allowing them full access to our national branch network. We are on track to deliver the remaining changes as expected.
- A drive to implement more effective structures and increase automation throughout the business, contributing to stronger future sustainability and a more efficient operating model.
- Investing in the development of our digital capabilities and preparation for Open Banking.
- Continued work towards achieving IRB advanced capital management status.
- Enhanced focus on the customer journey, enabling us to deliver an improved branch experience for our customers, in addition to delivering an average interest rate on our savings products of 1.05%[5] compared to the rest of the market of 0.68%[6].
- Delivering against our regulatory requirements including IFRS9, GDPR and PSD2.

Investing in the development of our digital capabilities and preparation for Open Banking.

5 Savings rate differential is defined on page 185 of the 2017 Annual Report and Accounts.
6 Source: CACI's CSDB, stock, April 2018.

Chief Executive's summary continued...

We are delighted that our customers and industry professionals continue to recognise our hard work as underlined by the number and calibre of awards that we have already won this year:

Award	Accolade
Moneynet Personal Finance Awards	Best Overall Mortgage Provider
Moneynet Personal Finance Awards	Best Offset Mortgage Provider
Moneynet Personal Finance Awards	Best First Time Buyer Mortgage Provider
National Centre for Diversity Grand Awards	UK's Most Improved Organisation of the Year 2018
National Centre for Diversity Grand Awards	UK Financial Services Company of the Year
PEX Network Awards 2018	Most Innovative Approach to Driving Culture Change
Moneyfacts Consumer Awards 2018	First-Time Mortgage Buyers' Choice
Annual LSL Group Awards	Most Improved Lender
Business Moneyfacts Awards	Best Service from a Commercial Mortgage Provider
Third Sector Business Charity Awards	CSR Team of the Year
Institute of Internal Communications North Awards 2018	Most Effective Culture Change Programme
Institute of Internal Communications North Awards 2018	Best Evaluation and Measurement
Moneywise Mortgage Awards 2018	Best Lender for Discount Mortgages

Our colleagues continue to play a key part in providing a great customer experience for our members and we are focused on creating an environment where our people are engaged, happy and committed. I recognise that there is a lot of change in the organisation at the moment and would like to thank all colleagues for their ongoing support and commitment.

Mike Regnier,
Chief Executive

Business highlights

The focus of the Board for the first half of 2018 has been on:

- Managing our mortgage and savings business and ensuring alignment to our commercial strategy.
- Maintaining and refining our risk management framework to protect our customers and ensure our ongoing operational and financial sustainability.
- Overseeing the progress of our project portfolio, in particular the elements of the portfolio that relate to changes in our branding, products and distribution capabilities.
- Delivering and continually enhancing exceptional customer service.
- Ensuring that we maintain our capital and liquidity ratios above the regulatory minimums and at a level that is efficient and sustainable.
- Focusing on our people programmes to bring about a cultural evolution, with engaging leadership and a diverse and inclusive colleague environment.
- Reviewing our strategic direction and purpose in order to make sure we remain relevant and competitive in today's environment.

YBS GROUP

Business highlights continued...

Profit before tax was £88.6m for the six months to 30 June 2018 compared to £92.3m for the equivalent period in 2017.

In addition to monitoring profit before tax (a statutory measure) the Board uses core operating profit as a measure of underlying performance. This adjusts the pre-tax profit for non-core items, both positive and negative, that are considered one-off in nature or reflect a difference that will reverse over time. We believe that core operating profit represents a clearer way of showing the underlying performance of the business.

Our core operating profit for the six months to 30 June 2018 was £86.3m against £84.2m in the same period in 2017. The table below explains the adjustments made to statutory profit to arrive at the core operating profit figure.

		Half-year ended 30 June 2018			Half-year ended 30 June 2017			Year ended 31 December 2017		
	NOTES	Statutory	Non-core items	Core	Statutory	Non-core items	Core	Statutory	Non-core items	Core
		£m	£m	£m	£m	£m	£m	£m	£m	£m
Net interest income	i)	**237.6**	**(2.5)**	**235.1**	238.7	–	238.7	502.1	(3.5)	498.6
Non-interest income (net)	ii)	**5.3**	**0.2**	**5.5**	11.1	(5.3)	5.8	14.5	(5.1)	9.4
Volatility on assets held at fair value	iii)	–	–	–	5.7	(5.7)	–	5.7	(5.7)	–
Fair value volatility on derivatives and hedging	iv)	**1.5**	**(1.5)**	–	8.1	(8.1)	–	7.4	(7.4)	–
Net realised profits		**4.6**	–	**4.6**	9.7	–	9.7	6.1	–	6.1
Total income		**249.0**	**(3.8)**	**245.2**	273.3	(19.1)	254.2	535.8	(21.7)	514.1
Management expenses		**(158.0)**	–	**(158.0)**	(159.3)	–	(159.3)	(339.5)	–	(339.5)
Operating profits before provisions		**91.0**	**(3.8)**	**87.2**	**114.0**	**(19.1)**	**94.9**	**196.3**	**(21.7)**	**174.6**
Impairment of loans and advances to customers		**(1.2)**	–	**(1.2)**	3.0	–	3.0	9.8	–	9.8
Other provisions	v)	**(1.2)**	**1.5**	**0.3**	(24.7)	11.0	(13.7)	(40.3)	16.1	(24.2)
Profit before tax		**88.6**	**(2.3)**	**86.3**	**92.3**	**(8.1)**	**84.2**	**165.8**	**(5.6)**	**160.2**

The notes below explain the adjustments made to statutory profit to arrive at the core operating profit figure.

i) Release of fair value adjustments made against assets taken on during mergers.

ii) Write off of Visa Shares £0.2m in 2018. Proceeds from the sale of VocaLink shares (£3.2m) and profit on the sale of properties (£1.9m) in 2017.

iii) Non-core investments held at fair value. £5.7m gain on Valleriite investment in 2017 – see Note 2.

iv) Fair value timing differences due to rate volatility on financial instruments – see Note 2.

v) £2.9m additional provision for restructuring costs (2017: £13.6m) offset by £1.4m release of Financial Services Compensation Scheme levy (2017: £2.5m charge) - see Note 6.

Business highlights continued...

The main items in the income statement that contribute to profit:

- Net interest income of £237.6m (30 June 2017: £238.7m) representing a net interest margin* of 1.16% (30 June 2017: 1.20%). This reduction reflects margin pressure on new business and is in line with our plans.
- Non-interest income decreased to £5.3m (30 June 2017: £11.1m). 2017 included £1.9m of profits from property disposals and £3.2m of income from VocaLink shares sold to Mastercard in H1.
- Fair value volatility of £1.5m (30 June 2017: £13.8m) is lower than 2017 when we saw the unwind of adverse movements in prior years as the underlying transactions matured. 2017 additionally included a £5.7m gain on a structured credit asset previously written down that recovered in value.
- Net realised profits of £4.6m (30 June 2017: £9.7m) reflect profits made on disposal of liquid asset investments in H1.
- Management expenses at a total level are comparable to last year at £158.0m (30 June 2017: £159.3m) with a cost:income ratio* of 63% (30 June 2017: 58%). Although the half-year cost position appears similar to 2017, the headline metric is materially influenced by the reporting classification of our project spend, which although broadly consistent across the two years was split differently between expenses and provisions. Underlying management expenditure has reduced by 10% year on year.
- Impairment provisions reflect a charge of £1.2m (30 June 2017: release of £3.0m). The quality of our mortgage books remain strong and underlying arrears levels have continued to fall this year. The 2018 charge has been calculated in accordance with the new accounting standard IFRS 9 Financial Instruments, the prior year comparatives were calculated under IAS 39. Adoption of this new standard did not materially impact the income statement and further details of the transitional impact is provided in Note 1 to the accounts.
- The charge for other provisions of £1.2m is significantly lower than the equivalent period last year (30 June 2017: £24.7m); the key components of the 2017 charge were:
  - a reduction in the Financial Services Compensation Scheme (FSCS) charge, offset by;
  - increases in provisions for Payment Protection Insurance (PPI);
  - a provision for restructuring costs.

  The key components of the 2018 charge are:
  - a further reduction in provision for the FSCS charge;
  - additional provisioning for restructuring costs.

As a mutual we do not pay dividends to external shareholders so our profit requirements are driven solely by our need for ongoing capital. Our overall profit level remains sufficient to provide capital for our current and future growth aspirations and ensure we are resilient to severe economic stresses.

The Group's business activities are focused in the UK and relate predominantly to mortgage lending which is funded primarily through domestic deposits. We continue to have a cautious approach to liquidity management and as at 30 June 2018 our liquidity portfolio consisted almost entirely of exposures to the Bank of England and the UK Government.

* These performance measures are defined in the glossary on page 183 of the 2017 Annual Report and Accounts.

Business highlights continued...

Principal risks and uncertainties

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.

A description of the principal risks and uncertainties is given in this report to the extent they remain prevalent or differ from those at 31 December 2017. The principal risks and uncertainties facing the Society for the year ended 31 December 2017 were reported on pages 35 to 36 of the 2017 Annual Report and Accounts.

Macroeconomic

- Political uncertainty in the UK

Whilst the UK financial system has remained relatively stable in the period following the vote to exit the European Union, the continued uncertainty surrounding the terms of the exit agreement and the risk of disruption this may pose to the UK economy and financial system, as well as ongoing debate in relation to UK devolution, mean that any adverse implications from the UK's exit from the EU must continue to be closely monitored.

- Market pressures on core business

Despite the UK interest rates rising for the first time in ten years in November 2017 and further increases expected to be seen in 2018/19, 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 savings rates. As a result, growth opportunities may prove difficult within the Group's core markets and the Group's business model may potentially be impacted.

- Funding Markets and Government schemes

The Group has considered and factored in future anticipated pressures on funding markets and the end of government funding schemes such as Funding for Lending Scheme (FLS) and Term Funding Scheme (TFS) within its 5 year corporate plan. The Group will ensure that it maintains a stable and diversified funding base to support balance sheet lending activities and to meet operational requirements. Repayment timings of TFS and FLS have been phased in such a way to allow for greater flexibility to funding plans. Our Plans anticipate a widening of funding spreads which have been factored into margin projections.

Financial crime and cyber security

- 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 remains paramount in order to keep these evolving financial crime exposures within the Group's risk appetite.

The Group has continued to invest in this area focusing particularly on Money Laundering, Terrorist Financing and Sanctions Compliance, looking at appropriately upgrading business standards, due diligence, IT and people capability.

- 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 – including ransomware, data breaches and weaknesses in the supply chain. 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

- 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.

Business highlights continued...

Legal and Regulatory Compliance

- 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.

Changing market for financial services

- Increased competition and new technology

The activities of challenger banks and Financial Technology firms, as well as the digital transformation that gathers momentum, will continue to accelerate changes in customer expectations. This may in turn threaten product pricing and potentially erode margins, as well as create a need to further enhance the Group's risk management capabilities across a number of risk categories. 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.

Business highlights continued...

Outlook for 2018

The level of political and economic uncertainty arising from both UK government and the ongoing negotiations around exit from the EU is likely to be maintained for some time. This continues to create market volatility; however the Group is well positioned with strong capital and liquidity positions. We are confident that we can continue to manage these risks as we run and continue to grow our business.

There is a level of uncertainty over the timing of the next rate increase in the UK with the market assumption of the next rise moving regularly. Our approach to any future changes will continue to focus on managing changes as sympathetically as possible for our customers, whilst maintaining clear focus on our position relative to peers and safeguarding our financial strength and sustainability.

We will ensure that we monitor any further risks that emerge.

Auditor

In accordance with the UK Corporate Governance Code requirements that an audit contract should be put out to tender at least every ten years an audit tendering process is being conducted.

Changes to the Board

A complete list of the board of directors can be found in the 2017 Annual Report and Accounts and there have been no changes to the directors during the first six months of 2018. As previously reported the Board agreed to commence a 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 and this recruitment process continues.

Signed on behalf of the Board by:

Alasdair Lenman, Chief Finance Officer

Mike Regnier, Chief Executive
25 July 2018

Forward-looking statements

This Interim Management Report has been prepared solely to provide additional information to members to assess the Group's performance and strategies, and should not be relied on by any other party or for any other purpose. It contains certain forward-looking statements, which are made by the directors in good faith based on the information available to them up to the time of their approval of this report. Such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying any such forward-looking information.

Condensed Group Income Statement

	Notes	Half-year to 30 June 2018 (Unaudited) £m	Half-year to 30 June 2017 (Unaudited) £m	Year to 31 December 2017 (Audited) £m
Interest receivable and similar income		**520.7**	533.9	1,078.2
Interest payable and similar charges		**(283.1)**	(295.2)	(576.1)
Net interest income		**237.6**	238.7	502.1
Fees and commissions receivable		**15.0**	16.5	30.7
Fees and commissions payable		**(10.9)**	(12.1)	(24.2)
Net fee and commission income		**4.1**	4.4	6.5
Net gains from fair value volatility on financial instruments	2	**1.5**	13.8	13.1
Net realised profits	3	**4.6**	9.7	6.1
Other operating income	4	**1.2**	6.7	8.0
Total income		**249.0**	273.3	535.8
Administrative expenses		**(147.7)**	(146.6)	(308.1)
Depreciation and amortisation		**(10.3)**	(12.7)	(31.4)
Operating profit before provisions		**91.0**	114.0	196.3
Impairment of loans and advances to customers	5	**(1.2)**	3.0	9.8
Provisions	6	**(1.2)**	(24.7)	(40.3)
Profit before tax		**88.6**	92.3	165.8
Tax expense	7	**(19.3)**	(23.3)	(41.4)
Net profit		**69.3**	**69.0**	**124.4**

Condensed Group Statement of Comprehensive Income

	Notes	Half-year to 30 June 2018 (Unaudited) £m	Half-year to 30 June 2017 (Unaudited) £m	Year to 31 December 2017 (Audited) £m
Net profit		**69.3**	69.0	124.4
Items that will subsequently be reclassified to profit and loss: Fair value through other comprehensive income investments:				
Valuation gains taken to equity		**(5.2)**	12.1	11.6
Amounts transferred to income statement		**1.2**	(13.6)	(8.0)
Tax on fair value through other comprehensive income securities	7	**1.1**	0.4	(1.0)
Effect of change in corporation tax rate	7	–	–	0.1
Cash flow hedges:				
Gains taken to equity		**0.8**	3.9	2.2
Amounts transferred to income statement		**0.8**	(0.5)	3.8
Tax on cash flow hedge reserve	7	**(0.4)**	(0.9)	(1.6)
Effect of change in corporation tax rate	7	–	–	0.1
Items that will not subsequently be reclassified to profit and loss:				
Remeasurement of net retirement benefit obligations	8	**9.6**	(32.1)	49.6
Tax relating to retirement benefit obligations	7	**(2.5)**	8.1	(13.5)
Effect of change in corporation tax rate	7	–	–	1.2
Total comprehensive income for the period		**74.7**	**46.4**	**168.9**

Condensed Group Statement of Financial Position

	Notes	30 June 2018 (Unaudited) £m	30 June 2017 (Unaudited) £m	31 December 2017 (Audited) £m
ASSETS				
Liquid Assets				
Cash in hand and balances with the Bank of England		**4,229.4**	4,111.1	4,893.9
Loans and advances to credit institutions		**265.2**	432.2	351.0
Debt securities		**1,500.0**	454.9	850.8
Loans and advances to customers		**35,464.4**	34,038.5	35,061.2
Fair value adjustment for portfolio hedged risk		**(37.9)**	–	–
Derivative financial instruments		**549.7**	573.2	591.8
Investments		**5.6**	5.1	6.3
Intangible assets		**31.7**	30.2	32.2
Investment properties		**12.2**	12.2	12.4
Property, plant and equipment		**110.6**	120.1	113.3
Deferred tax assets	7	**8.9**	10.5	8.7
Retirement benefit surplus	8	**106.6**	13.7	95.2
Other assets		**35.6**	35.0	30.4
Total assets		**42,282.0**	**39,836.7**	**42,047.2**
LIABILITIES				
Shares		**28,751.7**	28,440.0	28,938.0
Amounts owed to credit institutions		**5,342.0**	3,334.0	4,451.6
Other deposits		**428.0**	419.3	420.2
Debt securities in issue		**4,427.5**	4,695.8	4,933.3
Derivative financial instruments		**122.0**	261.7	156.9
Current tax liabilities	7	**14.9**	15.4	19.4
Deferred tax liabilities	7	**35.7**	8.5	29.6
Other liabilities		**50.9**	41.8	62.5
Provisions		**39.6**	45.9	45.8
Subordinated liabilities		**594.8**	300.4	593.7
Subscribed capital		**6.3**	6.6	6.4
Total liabilities		**39,813.4**	**37,569.4**	**39,657.4**
Total equity attributable to members		**2,468.6**	2,267.3	2,389.8
Total liabilities and equity		**42,282.0**	**39,836.7**	**42,047.2**

Condensed Group Statement of Changes in Members' Interest

	Notes	General reserve	Hedging reserve	Available for sale reserve	Fair value through other comprehensive income reserve	Total reserves
		£m	£m	£m	£m	£m
HALF-YEAR TO 30 JUNE 2018						
At 1 January 2018 (Audited)		**2,382.6**	**(3.6)**	**10.8**	**–**	**2,389.8**
IFRS 9 transition adjustments	**1**	**5.8**	**–**	**(10.8)**	**9.1**	**4.1**
Current period movement net of tax		**76.4**	**1.2**	**–**	**(2.9)**	**74.7**
At 30 June 2018 (Unaudited)		**2,464.8**	**(2.4)**	**–**	**6.2**	**2,468.6**
HALF-YEAR TO 30 JUNE 2017						
At 1 January 2017 (Audited)		2,220.9	(8.1)	8.1	–	2,220.9
Current period movement net of tax		45.0	2.5	(1.1)	–	46.4
At 30 June 2017 (Unaudited)		2,265.9	(5.6)	7.0	–	2,267.3
YEAR TO 31 DECEMBER 2017						
At 1 January 2017 (Audited)		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 (Audited)		2,382.6	(3.6)	10.8	–	2,389.8

Condensed Group Statement of Cash Flows

	Notes	Half-year to 30 June 2018 (Unaudited) £m	Half-year to 30 June 2017 (Unaudited) £m	Year to 31 December 2017 (Audited) £m
CASH FLOWS FROM OPERATING ACTIVITIES:				
Profit before tax		**88.6**	92.3	165.8
Working capital adjustments	10	**(33.6)**	3.3	51.8
Net decrease in operating assets	10	**(407.4)**	(34.3)	(1,122.0)
Net increase/(decrease) in operating liabilities	10	**711.9**	(55.4)	1,561.1
Taxation paid		**(20.1)**	(15.1)	(28.5)
Net cash flows from/(used in) operating activities		**339.4**	**(9.2)**	**628.2**
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of property, plant and equipment and intangible assets		**(6.9)**	(1.5)	(18.2)
Proceeds from sale of property, plant and equipment		**–**	6.8	9.3
Purchase of debt securities		**(1,163.6)**	(474.4)	(1,031.2)
Proceeds from sale and redemption of debt securities		**515.0**	635.9	798.2
Net cash flows (used in)/from investing activities		**(655.5)**	**166.8**	**(241.9)**
CASH FLOWS FROM FINANCING ACTIVITIES:				
Redemption of securities		**(894.2)**	(100.7)	(213.4)
Issue of securities	10	**443.5**	426.7	726.7
Redemption of subordinated liabilities		**(5.0)**	–	(5.0)
Issue of subordinated liabilities		**–**	–	300.0
Interest paid on subordinated liabilities and subscribed capital		**(12.9)**	(8.0)	(19.1)
Net cash flows (used in)/from financing activities		**(468.6)**	**318.0**	**789.2**
Net (decrease)/increase in cash and cash equivalents		**(784.7)**	**475.6**	**1,175.5**
Opening balance		**5,191.7**	4,016.2	4,016.2
Total closing cash and cash equivalents		**4,407.0**	**4,491.8**	**5,191.7**
CASH AND CASH EQUIVALENTS:				
Cash and balances with central banks		**4,141.8**	4,059.6	4,840.7
Loans and advances to credit institutions		**265.2**	432.2	351.0
		4,407.0	4,491.8	5,191.7

Notes to the accounts

1. Introduction

Reporting period

The financial statements show the financial performance of the Group for the half-year ended 30 June 2018.

Basis of preparation

These Interim Group Accounts have been prepared in accordance with International Accounting Standard (IAS) 34 'Interim Financial Reporting'. The accounting policies, presentation and methods of computation are consistent with those applied by the Group in its latest audited Annual Financial Statements, which were prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, with the exception of IFRS 9 and IFRS 15 which the Group has adopted with effect from 1 January 2018.

Going concern

The Board undertakes regular rigorous assessments of whether the Group is a going concern in light of current economic and market conditions and all available information about future risks and uncertainties. Details of the review undertaken in February 2018 are given on page 37 of the 2017 Annual Report and Accounts.

The directors confirm, based on the latest formal review undertaken in July 2018, that they consider the Group has adequate resources to continue in existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing these financial statements.

Accounting developments

The information on future accounting developments and their potential effect on the financial statements are provided on pages 100 and 101 of the 2017 Annual Report and Accounts.

IFRS 15

The main principle of IFRS 15 is that revenue reflects the transfer of goods and services to customers in a manner that reflects the expected consideration, a five step model for the recognition of revenue is then followed. The majority of the Group's revenue is out of the scope of IFRS 15 as it is in the form of interest income from financial instruments. An assessment of all revenue streams in scope has been performed and there are no changes in the recognition of revenue as a consequence of the new standard.

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.

Classification and measurement

Under IFRS 9, financial assets are classified at 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 resulted in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39, this did not materially impact the Group. Further details on the impact of these changes are contained within the tables on page 22.

Impairment

Under IFRS 9, impairment is based on a more forward looking expected credit loss (ECL) approach for financial assets classified at 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 expected credit losses ('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 assesses 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 assess a significant increase in credit risk using a combination of individual and collective information, including monitoring through the watchlist process.

Financial assets are 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 remains consistent with the prior year as detailed on page 164 of the 2017 Annual Report and Accounts. Arrears arrangements, payment holiday, term extension, transfers to interest only and interest capitalisation are all included in the criteria for identifying

stage 3 accounts. The population of stage 3 loans is similar to that of impaired loans under IAS 39. The impairment provision is determined using the same calculation as stage 2, but with the PD set to 100%. The calculated provision therefore differs 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 has based the ECL calculations for retail portfolios on those used to calculate Basel expected losses ('EL's) 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.
- 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 £684.9m of loans acquired as part of the Chelsea and Norwich and Peterborough 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 the 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, for which the Group continued 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 currently has no committed plans to adopt the IFRS 9 hedge accounting requirements but will continue to monitor the adoption decision.

Transition

The classification and measurement and impairment requirements were applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The tables showing the impact of transition on the financial statements are disclosed on page 21, further analysis of the impairment provision is disclosed in Note 5.

As at 31 December 2017, the Group had an IAS 39 impairment provision of £32.4m. On transition to IFRS 9, impairment provisions decreased to £29.3m, resulting in the difference of £3.1m being recognised through reserves.

There was no change to the write off policy applied under IFRS 9. Loans 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.

IAS 1 amendments

Following the introduction of IFRS 9 there have been some consequential amendments to IAS 1 Presentation of Financial Statements. The amendments require separate disclosure of interest revenue calculated using the effective interest rate method ('EIR'). During the six months to 30 June 2018 interest receivable and similar income of £520.7m was all calculated using the EIR method except for £43.7m of net income on financial instruments.

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, with the below key sources of estimation uncertainty changing since the 2017 year-end as a result of the adoption of IFRS 9.

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). The most critical sources of estimation uncertainty are:

- the economic scenarios and associated probability weightings, for which the Group has applied a 30% and 10% weighting to its downside and stress scenarios. A 5% increase or decrease in both of these weightings would give rise to a £9.4m increase or decrease in the provision, respectively;
- the threshold applied to assess whether a significant relative increase in credit risk has occurred. If 10% of the accounts in stage 1 were to be transferred to stage 2 and subject to a calculation of full lifetime expected credit losses, this would result in a £4.5m increase in the provision;
- the calculation of the probability of default (PD) for accounts in stage 2 and the probability of possession (PP) for accounts in stage 3. A 10% relative increase or decrease in these probabilities would give rise to a £6.9m increase or decrease in the provision, respectively; and
- the assessment of whether a significant increase in credit risk has occurred and the PD rates for customers who are indebted on their unsecured lending or using a high proportion of their available credit. For such accounts that have been classified as stage 1, there would be a £7.9m increase in provision if these were transferred to stage 2 and subject to a calculation of full lifetime expected credit losses.

As described on page 106 of the 2017 Annual Report and Accounts, the calculation of the expected loss for assets acquired as part of the business combinations is also inherently uncertain and contains estimates around future economic conditions and customer behaviour. The expected credit losses include £17.9m in respect of interest only mortgage accounts acquired from Chelsea Building Society, where there is significant uncertainty as to the PD and LGD. The calculation applied to estimate the losses has not substantially changed under IFRS 9, such that the source and range of estimation uncertainty is similar to that disclosed previously.

Group Statement of Financial Position

Only Financial Statement line items that have been materially impacted by the new Accounting Standards are disclosed below. As this is only an extract, the line items disclosed in total do not come to the entire total assets or total liabilities figures.

	31 December 2017 As originally presented (Audited)	IFRS 9	1 January 2018 Restated (Unaudited)
	£m	£m	£m
Financial assets at fair value through other comprehensive income	–	847.0	**847.0**
Financial assets at fair value through profit or loss	3.8	6.3	**10.1**
Financial assets at amortised cost	40,306.1	4.4	**40,310.5**
Available for sale financial assets	853.3	(853.3)	–
Deferred tax assets	8.7	1.6	**10.3**
Total assets	42,047.2	6.0	**42,053.2**
Deferred tax liabilities	29.6	1.9	**31.5**
Total liabilities	39,657.4	1.9	**39,659.3**
Available for sale reserve	10.8	(10.8)	–
Fair value through other comprehensive income reserve	–	9.1	**9.1**
General reserves	2,382.6	5.8	**2,388.4**
Total equity and liabilities	42,047.2	6.0	**42,053.2**

Group Statement of Changes in Members' Interest

The total impact on the Group's equity attributable to members as at 1 January 2018 is as follows:

	General reserve	Hedging reserve	Available for sale reserve	Fair value through other comprehensive income	Total reserves
	£m	£m	£m	£m	£m
Closing balances at 31 December 2017 - IAS 39 (Audited)	**2,382.6**	**(3.6)**	**10.8**	**–**	**2,389.8**
Reclassify investments from available for sale to fair value through profit or loss	1.7	–	(1.7)	–	–
Reclassify debt securities from available for sale to fair value through other comprehensive income	–	–	(9.1)	9.1	–
Remeasurement of financial assets at amortised cost (including provision for credit losses)	4.4	–	–	–	4.4
Remeasurement of deferred tax balances	(0.3)	–	–	–	(0.3)
Opening equity attributable to members - IFRS 9 (Unaudited)	**2,388.4**	**(3.6)**	**–**	**9.1**	**2,393.9**

Classification and measurement

The impact of IFRS 9 on asset classifications is detailed below. There were no changes in classification of financial liabilities.

IAS 39 classification and measurement	IFRS 9 classification and measurement	31 December 2017 (Audited)	1 January 2018 (Unaudited)
		£m	£m
CASH IN HAND AND BALANCES WITH THE BANK OF ENGLAND			
Loans and receivables at amortised cost	Financial assets at amortised cost	4,893.9	**4,893.9**
LOANS AND ADVANCES TO CREDIT INSTITUTIONS			
Loans and receivables at amortised cost	Financial assets at amortised cost	351.0	**351.0**
DEBT SECURITIES			
Available for sale - debt	Fair value through other comprehensive income	847.0	**847.0**
Held for trading	Fair value through profit or loss	3.8	**3.8**
LOANS AND ADVANCES TO CUSTOMERS			
Loans and receivables at amortised cost	Financial assets at amortised cost	35,061.2	**35,065.6**
DERIVATIVE FINANCIAL INSTRUMENTS			
Held for trading	Fair value through profit or loss	591.8	**591.8**
INVESTMENTS			
Available for sale - equity	Fair value through profit or loss	6.3	**6.3**

2. Net gains from fair value volatility on financial instruments

	Half-year to 30 June 2018 (Unaudited)	Half-year to 30 June 2017 (Unaudited)	Year to 31 December 2017 (Audited)
	£m	£m	£m
Derivatives and hedging	**1.0**	8.1	7.4
Other items	**0.5**	5.7	5.7
	1.5	13.8	13.1

Derivatives and hedging

Fair value volatility on derivatives and hedging relates to changes in the fair value of derivatives that provide effective economic hedges but where the Group has either not achieved hedge accounting or the nature of the hedge relationship has given rise to ineffectiveness. The £5.7m other item in the prior period related to the realised gain on the maturity of a structured credit investment.

3. Net realised profits

These relate to the disposal of liquid asset investments and include the realised profits on any associated derivatives. Profits or losses of this nature are variable as these sales are largely made to efficiently and effectively manage our liquidity portfolio investments and to prove the liquidity of the assets held.

4. Other operating income

Other operating income primarily comprises of income from fixed assets; specifically profits and losses from disposals, rental income from investment property and software licensing income. The material reduction in other income for the period to 30 June 2018 is due to exceptional items in the prior period as the Group received £3.2m in respect of the Group's interest in VocaLink, which was purchased by Mastercard on 2 May 2017, and also realised profits of £1.9m on the disposal of property.

5. Impairment provisions

On the 1 January 2018, the Group transitioned to a new accounting standard for the calculation of impairments. Details of accounting policies under this standard are included in the accounting developments update in Note 1.

Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles the prior period's impairment allowance in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected loss model at 1 January 2018:

	Loan loss allowance under IAS 39	Reclassification	Remeasurement	Loan loss allowance under IFRS 9
	£m	£m	£m	£m
LOANS AND RECEIVABLES (IAS 39)/ FINANCIAL ASSETS AT AMORTISED COST (IFRS 9)				
Loans and advances to customers - Impairments	32.4	–	(3.1)	29.3

The following tables analyse the IFRS 9 stage for gross loans and advances to customers.

	STAGE 1	STAGE 2	STAGE 3	
30 JUNE 2018 (Unaudited)	**12 month expected credit losses**	**Lifetime expected credit losses**	**Lifetime expected credit losses**	**Total**
	£m	£m	£m	£m
Gross loans and advances to customers	**27,644.8**	**6,926.6**	**1,020.3**	**35,591.7**

	STAGE 1	STAGE 2	STAGE 3	
1 JANUARY 2018 (Unaudited)	**12 month expected credit losses**	**Lifetime expected credit losses**	**Lifetime expected credit losses**	**Total**
	£m	£m	£m	£m
Gross loans and advances to customers	28,080.5	6,065.6	1,080.3	35,226.4

The balances shown above exclude effective interest rate, hedge accounting and fair value adjustments. No analysis has been provided for other balance sheet categories as the entire gross balance is classified as stage 1.

Year to date IFRS 9 impairment provision movements

The following table details the movement in the impairment provision from the beginning to the end of the interim reporting period split by class of financial instrument. Purchase Originated Credit Impaired is included within stage 3.

Loans and advances to customers	STAGE 1	STAGE 2	STAGE 3	
	12 month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses	Total
	£m	£m	£m	£m
Impairment provision at 1 January 2018 (Unaudited)	**1.1**	**20.0**	**8.2**	**29.3**
MOVEMENTS WITH INCOME STATEMENT IMPACT				
Transfers:				
Transfers from stage 1 to 2	(0.3)	2.2	–	1.9
Transfers from stage 1 to 3	–	–	0.1	0.1
Transfers from stage 2 to 1	–	(1.4)	–	(1.4)
Transfers from stage 2 to 3	–	(0.4)	0.3	(0.1)
Transfers from stage 3 to 1	–	–	(0.4)	(0.4)
Transfers from stage 3 to 2	–	0.2	–	0.2
New financial assets originated or purchased	0.1	–	–	0.1
Changes in PDs/LGDs/EADs	0.2	0.5	0.2	0.9
Financial assets derecognised during the period	(0.1)	(0.6)	(0.2)	(0.9)
Write-offs	–	–	(1.5)	(1.5)
Impairment provision at 30 June 2018 (Unaudited)	**1.0**	**20.5**	**6.7**	**28.2**

The following tables analyse the ECL stages split by the number of days past due (DPD). No further analysis has been provided where the entire provision for a financial asset is stage 1 and <30 DPD.

Loans and advances to customers	STAGE 1		STAGE 2		STAGE 3		
	12 month expected credit losses		Lifetime expected credit losses		Lifetime expected credit losses		Total
	<30 DPD	>30 DPD	<30 DPD	>30 DPD	<90 DPD	>90 DPD	
	£m	£m	£m	£m	£m	£m	£m
Impairment provision at 30 June 2018 (Unaudited)	**1.0**	–	**19.6**	**0.9**	**0.7**	**6.0**	**28.2**

Loans and advances to customers	STAGE 1		STAGE 2		STAGE 3		
	12 month expected credit losses		Lifetime expected credit losses		Lifetime expected credit losses		Total
	<30 DPD	>30 DPD	<30 DPD	>30 DPD	<90 DPD	>90 DPD	
	£m	£m	£m	£m	£m	£m	£m
Impairment provision at 1 January 2018 (Unaudited)	1.1	–	19.2	0.8	0.8	7.4	29.3

The Group continues to use forbearance to assist borrowers facing difficulties, balancing the best interests of the Group with those of the individual, where there is a realistic prospect of a borrower's circumstances improving within the foreseeable future.

6. Provisions

The provisions charge for the period is outlined below:

	Half-year to 30 June 2018 (Unaudited)	Half-year to 30 June 2017 (Unaudited)	Year to 31 December 2017 (Audited)
	£m	£m	£m
FSCS levy	**(1.4)**	2.5	2.5
Customer redress and conduct issues	–	12.2	19.7
Restructuring	**2.9**	8.5	13.6
Other	**(0.3)**	1.5	4.5
	1.2	24.7	40.3

Financial Services Compensation Scheme (FSCS) levy

The FSCS reimburses depositors when institutions fail using loans from HM Treasury, which are subsequently recovered from the failed institutions. Any shortfall in this recovery is levied on member firms, along with the interest costs on the loans.

The £1.4m provision release for the current period follows disposals by UK Asset Resolution Limited of certain mortgage assets relating to the Bradford and Bingley portfolio leading to repayment of the amount borrowed by FSCS from HM Treasury.

Customer redress and conduct issues

Provisions are held in respect of various potential customer claims and represent management's best estimate of the likely costs. The prior year charge predominately relates to PPI claims 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. No provisions have been recognised in the current period in respect of customer redress and conduct issues.

Restructuring

The £2.9m restructuring provision charge for the current period relates to business and organisational changes communicated during 2018.

7. Taxation

An effective tax rate of 19.09% has been applied to the Group's profit. This is higher than the standard corporation tax rate in the year of 19.00% due to non tax-deductible expenses.

A surcharge of 8% on the profits of banking companies (including building societies) applies. This increases the tax charge and is reflected in the tax balances. The main rate of corporation tax will reduce from 19% to 17% from 1 April 2020. These rate changes are reflected in the deferred tax balances.

8. Retirement benefit obligations

	At 1 January 2018 (Audited)	Movements	At 30 June 2018 (Unaudited)
	£m	£m	£m
Present value of defined benefit obligation	(899.1)	47.5	(851.6)
Assets at fair value	994.3	(36.1)	958.2
Funded status/defined benefit asset	**95.2**	**11.4**	**106.6**

The present value of the defined benefit obligation as at 30 June 2018 has been derived using assumptions that are consistent with those used for the 31 December 2017.

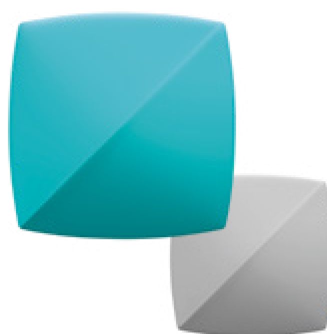
Corporate bond yields have increased over the first half of 2018, which has the effect of increasing the discount rate and reducing liabilities. Expectations of long term inflation have reduced, which has further reduced the liabilities. In addition, there has been a significant amount of benefits transferred out of the Scheme over the first half of the year and liabilities have been adjusted to reflect the higher benefit outgo than previously expected.

The fall in assets reflect the net cash flows out of the Scheme and broadly flat overall investment returns over the first half of 2018.

9. Related parties

The Society has an investment in Arkose Funding Limited. In 2014, a loan of £4.0m to Arkose Funding Limited was fully impaired.

There have been no material changes to related parties and the associated related party transactions since the year end. For further information on these see pages 173 to 175 of the 2017 Annual Report and Accounts.



10. Notes to the condensed Group Statement of Cash Flows

	Half-year to 30 June 2018 (Unaudited)	Half-year to 30 June 2017 (Unaudited)	Year to 31 December 2017 (Audited)
	£m	£m	£m
WORKING CAPITAL ADJUSTMENTS:			
Depreciation and amortisation	**10.3**	12.7	31.4
Profit on sale of assets	**–**	(2.1)	(1.9)
Interest on subordinated liabilities and subscribed capital	**12.9**	8.0	19.1
Provisions	**2.4**	21.7	30.5
Fair value of subordinated liabilities and subscribed capital	**6.0**	3.3	1.4
Net realised profits	**(4.6)**	(9.7)	(6.1)
Increase in other assets	**(41.5)**	(9.8)	(6.7)
Decrease in other liabilities	**(19.1)**	(20.8)	(15.9)
Working capital adjustments	**(33.6)**	**3.3**	**51.8**
(INCREASE)/DECREASE IN OPERATING ASSETS:			
Loans and advances to customers	**(361.8)**	67.8	(948.1)
Investments	**0.7**	5.2	4.0
Derivative financial instruments	**(46.3)**	(107.3)	(177.9)
Net increase in operating assets	**(407.4)**	**(34.3)**	**(1,122.0)**
INCREASE/(DECREASE) IN OPERATING LIABILITIES:			
Shares	**(186.3)**	(253.2)	244.8
Amounts owed to credit institutions	**890.4**	213.2	1,330.8
Other deposits	**7.8**	(15.4)	(14.5)
Net increase/(decrease) in operating liabilities	**711.9**	**(55.4)**	**1,561.1**

The following table reconciles liabilities arising from financing activities.

		Cash flows		Non-cash changes caused by:				
	31 December 2017 (Audited)	Redemption	Issue	Foreign exchange movement	Accrued interest	Fair value adjustments	Other	30 June 2018 (Unaudited)
	£m	£m	£m	£m	£m	£m	£m	£m
Debt securities in issue	4,933.3	(894.2)	443.5	(11.0)	(45.2)	1.8	(0.7)	**4,427.5**
Subordinated liabilities	593.7	(5.0)	–	–	10.0	(4.5)	0.6	**594.8**
Subscribed capital	6.4	–	–	–	–	(0.1)	–	**6.3**
Total liabilities from financing activities	5,533.4	(899.2)	443.5	(11.0)	(35.2)	(2.8)	(0.1)	**5,028.6**

Issue of securities

During the period, the Group issued €500m (£443.5m) of five year medium terms notes.

Cash and balances with central banks

Cash and balances with central banks excludes cash ratio deposits of £87.5m held with the Bank of England, which are not available for use in the Group's day-to-day operations.

11. 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 services. 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 the 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.

The accounting policies for the reported segments are consistent with the Group's accounting policies outlined in Note 1 of the 2017 Annual Report and Accounts.

HALF-YEAR TO 30 JUNE 2018 (UNAUDITED)		Retail	Non-retail	Secondary	Central	Total
	Notes	£m	£m	£m	£m	£m
Net interest income		161.9	12.7	10.0	53.0	237.6
Non-interest income (net)	a	8.3	–	–	(3.0)	5.3
Net realised profits and fair value		–	–	–	6.1	6.1
Management expenses	b	(91.3)	(1.3)	(0.7)	(64.7)	(158.0)
Operating profit/(loss) before provisions		**78.9**	**11.4**	**9.3**	**(8.6)**	**91.0**
Impairment and other provisions	c	(0.2)	(0.1)	0.7	(2.8)	(2.4)
Profit/(loss) before tax		**78.7**	**11.3**	**10.0**	**(11.4)**	**88.6**
Total assets		**33,681.2**	**1,122.2**	**660.9**	**6,817.7**	**42,282.0**
Total liabilities		**29,176.0**	**–**	**–**	**10,637.4**	**39,813.4**
Total equity attributable to members		**–**	**–**	**–**	**2,468.6**	**2,468.6**

HALF-YEAR TO 30 JUNE 2017 (UNAUDITED)		Retail	Non-retail	Secondary	Central	Total
	Notes	£m	£m	£m	£m	£m
Net interest income		168.4	10.3	11.7	48.3	238.7
Non-interest income (net)	a	10.7	–	–	0.4	11.1
Net realised profits and fair value		–	–	–	23.5	23.5
Management expenses	b	(101.0)	(1.3)	(0.9)	(56.1)	(159.3)
Operating profit before provisions		**78.1**	**9.0**	**10.8**	**16.1**	**114.0**
Impairment and other provisions	c	(0.7)	–	0.1	(21.1)	(21.7)
Profit/(loss) before tax		**77.4**	**9.0**	**10.9**	**(5.0)**	**92.3**
Total assets		**32,189.3**	**1,047.6**	**769.3**	**5,830.5**	**39,836.7**
Total liabilities		**29,041.6**	**–**	**–**	**8,527.8**	**37,569.4**
Total equity attributable to members		**–**	**–**	**–**	**2,267.3**	**2,267.3**

YEAR TO 31 DECEMBER 2017 (AUDITED)		Retail	Non-retail	Secondary	Central	Total
	Notes	£m	£m	£m	£m	£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/(loss) before provisions		**186.9**	**18.1**	**20.9**	**(29.6)**	**196.3**
Impairment and other provisions	c	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**
Total equity attributable to members		**–**	**–**	**–**	**2,389.8**	**2,389.8**

Notes

a) Non-interest income (net) includes fees and commissions receivable, fees and commissions payable, and other operating income.

b) Management expenses include administrative expenses, depreciation and amortisation.

c) Impairment provisions are included on an IAS 39 basis in 2017, and on an IFRS 9 basis in 2018.

Total income excluding net realised profits and fair value for the reportable segments can be analysed as follows:

HALF-YEAR TO 30 JUNE 2018 (UNAUDITED)	Retail	Non-retail	Secondary	Central	Total
	£m	£m	£m	£m	£m
External income	**271.3**	**21.9**	**15.1**	**(65.4)**	**242.9**
Income from other segments	**(101.1)**	**(9.2)**	**(5.1)**	**115.4**	–
Total income	**170.2**	**12.7**	**10.0**	**50.0**	**242.9**

HALF-YEAR TO 30 JUNE 2017 (UNAUDITED)	Retail	Non-retail	Secondary	Central	Total
	£m	£m	£m	£m	£m
External income	311.0	17.8	17.5	(96.5)	249.8
Income from other segments	(131.9)	(7.5)	(5.8)	145.2	–
Total income	**179.1**	**10.3**	**11.7**	**48.7**	**249.8**

YEAR TO 31 DECEMBER 2017 (AUDITED)	Retail	Non-retail	Secondary	Central	Total
	£m	£m	£m	£m	£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**

12. Fair values

Fair value is the price that would be received on the sale of 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.

AT 30 JUNE 2018 (UNAUDITED)	Carrying value	Fair values			Total Fair value
		Level 1	Level 2	Level 3	
	£m	£m	£m	£m	£m
ASSETS:					
Cash in hand and balances with the Bank of England	**4,229.4**	–	**4,229.4**	–	**4,229.4**
Loans and advances to credit institutions	**265.2**	–	**265.2**	–	**265.2**
Loans and advances to customers	**35,464.4**	–	–	**35,826.6**	**35,826.6**
LIABILITIES:					
Shares	**28,751.7**	–	**28,783.3**	–	**28,783.3**
Amounts due to credit institutions	**5,342.0**	–	**5,342.0**	–	**5,342.0**
Other deposits	**428.0**	–	**428.0**	–	**428.0**
Debt securities in issue	**4,427.5**	**3,894.5**	**599.0**	–	**4,493.5**
Subordinated liabilities	**594.8**	**551.4**	**43.2**	–	**594.6**
Subscribed capital	**6.3**	–	**6.2**	–	**6.2**

AT 31 DECEMBER 2017 (AUDITED)	Carrying value	Fair values			Total Fair value
		Level 1	Level 2	Level 3	
	£m	£m	£m	£m	£m
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

The table below classifies all financial instruments held at fair value according to the method used to establish the fair value.

AS AT 30 JUNE 2018 (UNAUDITED)	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
ASSETS:				
Debt securities – fair value	–	–	**3.4**	**3.4**
Debt securities – fair value through other comprehensive income	**1,493.2**	–	**3.4**	**1,496.6**
Derivative financial instruments	–	**528.4**	**21.3**	**549.7**
Investments	–	–	**5.6**	**5.6**
LIABILITIES:				
Derivative financial instruments	–	**119.0**	**3.0**	**122.0**

AS AT 31 DECEMBER 2017 (AUDITED)	Level 1	Level 2	Level 3	Total
	£m	£m	£m	£m
ASSETS:				
Debt securities – fair value	–	–	3.8	3.8
Debt securities – available for sale	843.4	–	3.6	847.0
Derivative financial instruments	–	560.8	31.0	591.8
Investments	–	–	6.3	6.3
LIABILITIES:				
Derivative financial instruments	–	152.7	4.2	156.9

The following table analyses movements in the Level 3 portfolio:

	As at 1 January 2018 (Audited)	Items recognised in the income statement	Net repayments in the period	Gains and losses in other comprehensive income	As at 30 June 2018 (Unaudited)
	£m	£m	£m	£m	£m
ASSETS:					
Debt securities – fair value	3.8	–	(0.4)	–	**3.4**
Debt securities – fair value through other comprehensive income	3.6	(0.2)	–	–	**3.4**
Derivative financial instruments	31.0	–	(0.2)	(9.5)	**21.3**
Investments	6.3	(0.7)	–	–	**5.6**
LIABILITIES:					
Derivative financial instruments	4.2	(1.5)	0.3	–	**3.0**

Details of valuation techniques are disclosed on page 171 of the 2017 Annual Report and Accounts.

There have been no transfers of assets or liabilities between the levels of the fair value hierarchy during the period.

Responsibility statement

We confirm that to the best of our knowledge, the condensed set of financial statements has been prepared in accordance with International Accounting Standard 34 'Interim Financial Reporting'; the interim report includes a fair review of the information required by DTR 4.2.7R (indication of important events during the first six months and description of principal risks and uncertainties for the remaining six months of the year); and the interim report includes a fair review of the information required by DTR 4.2.8R (disclosure of related parties' transactions and changes therein).

By order of the Board

Mike Regnier
Chief Executive

Alasdair Lenman
Finance Director

25 July 2018

Independent review report to Yorkshire Building Society

We have been engaged by the Society to review the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2018 which comprises the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Members' Interest, the Statement of Cash Flows and related Notes 1 to 12. We have read the other information contained in the half-yearly financial report and considered whether it contains any apparent misstatements or material inconsistencies with the information in the condensed set of financial statements.

This report is made solely to the Society in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board. Our work has been undertaken so that we might state to the Society those matters we are required to state to it in an independent review 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, for our review work, for this report, or for the conclusions we have formed.

Directors' responsibilities

The half-yearly financial report is the responsibility of, and has been approved by, the directors. The directors are responsible for preparing the half-yearly financial report in accordance with the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

As disclosed in Note 1, the annual financial statements of the Group are prepared in accordance with IFRSs as adopted by the European Union. The condensed set of financial statements included in this half-yearly financial report has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" as adopted by the European Union.

Our responsibility

Our responsibility is to express to the Society a conclusion on the condensed set of financial statements in the half-yearly financial report based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements (UK and Ireland) 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the Auditing Practices Board for use in the United Kingdom. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing (UK and Ireland) and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the condensed set of financial statements in the half-yearly financial report for the six months ended 30 June 2018 is not prepared, in all material respects, in accordance with International Accounting Standard 34 as adopted by the European Union and the Disclosure and Transparency Rules of the United Kingdom's Financial Conduct Authority.

Deloitte LLP
Statutory Auditor
Leeds, United Kingdom

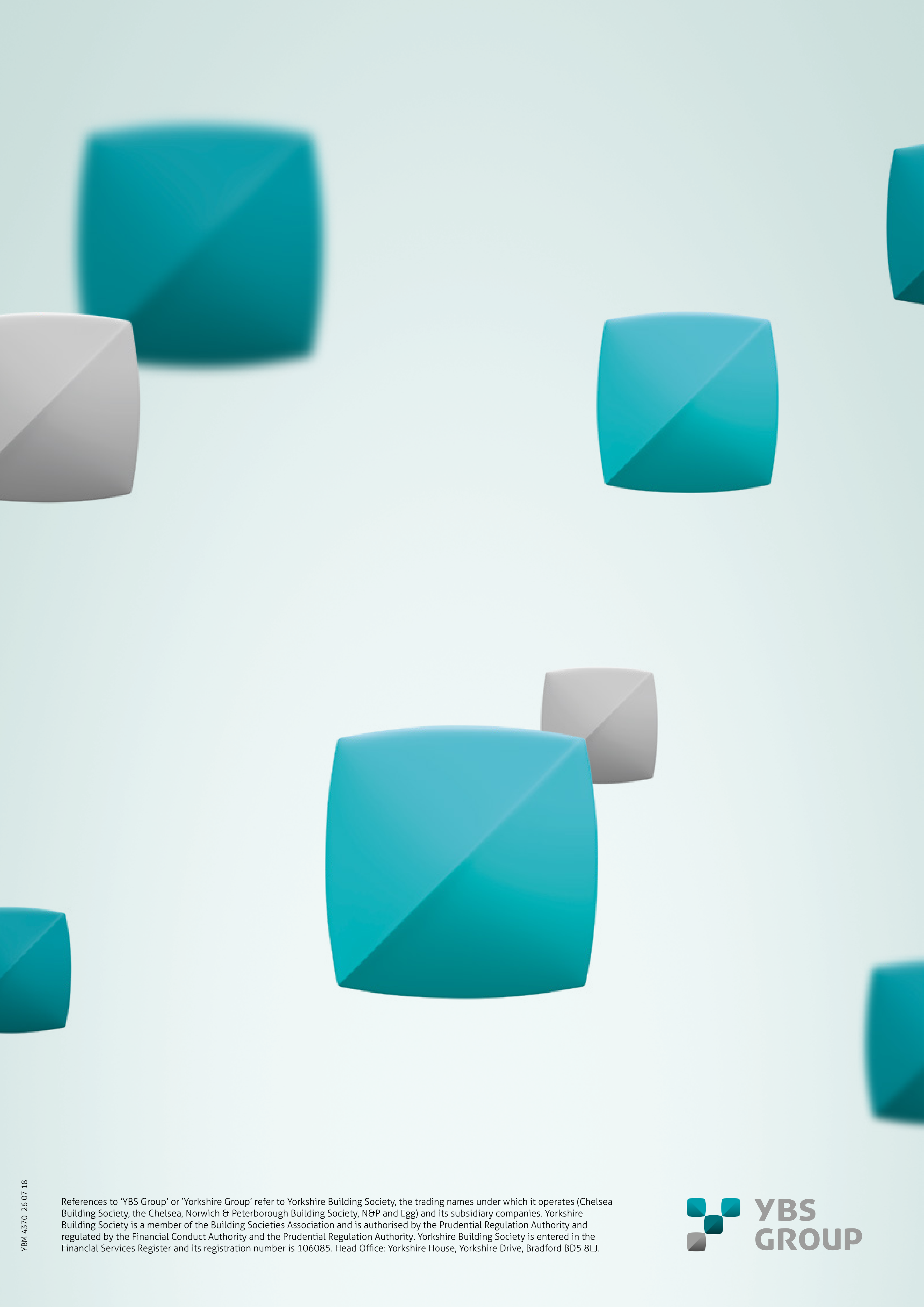
25 July 2018

Other information

The interim management report information set out in this document is unaudited and does not constitute accounts within the meaning of section 73 of the Building Societies Act 1986. The financial information for the year ended 31 December 2017 has been extracted from the Annual Accounts for that year. The Annual Accounts for the year ended 31 December 2017 have been filed with the Financial Conduct Authority.

The Auditor's report on the Annual Accounts was unqualified and did not include any matters to which the Auditor drew attention by way of emphasis without qualifying their report.

A copy of the interim management report is placed on Yorkshire Building Society's website. The directors are responsible for the maintenance and integrity of the information on the website. Information published on the internet is accessible in many countries with different legal requirements. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



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References to 'YBS Group' or 'Yorkshire Group' refer to Yorkshire Building Society, the trading names under which it operates (Chelsea Building Society, the Chelsea, Norwich & Peterborough Building Society, N&P and Egg) and its subsidiary companies. Yorkshire Building Society is a member of the Building Societies Association and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Yorkshire Building Society is entered in the Financial Services Register and its registration number is 106085. Head Office: Yorkshire House, Yorkshire Drive, Bradford BD5 8LJ.